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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

DAVID STIRLING, JR., WILLIAM G. STIRLING, AND HAROLD M. YANOWITCH,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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Petitioners, David Stirling, Jr., William G. Stirling and Harold M. Yanowitch, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case on February 2, 1978, with respect to which a petition for rehearing was denied on April 13, 1978.

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. App. A, pp. 1a-54a)[1] has not yet been reported.

JURISDICTION

The judgment of the Court of Appeals was entered on February 2, 1978. (Pet. App. B, pp. 55a-56a.) A petition for rehearing was denied on April 13, 1978. (Pet. App. C, p. 58a) The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the courts below properly construed the word "material" in 15 U.S.C. §77q, when the construction given raises serious constitutional doubts with respect to the privilege against self-incrimination, and double jeopardy, and is essentially contrary to this Court's decisions in *California* v. *Byers,* 402 U.S. 424 (1971), and *Marchetti* v. *United States,* 390 U.S. 39 (1968), with respect to self-incrimination, and *Brown* v. *Ohio,* 432 U.S. 161 (1977), with respect to double jeopardy.

2. Whether the court below improperly upheld the charge of the trial court with respect to materiality, although the trial court charged that the information

[1] The appendices to this petition will be cited as Pet. App. A, etc. Throughout this petition references noted by letter "A____" are references to the joint Appendix submitted to the court of appeals below. References to government and defense exhibits below will be made as "GX" and "DX" respectively. Reference to the Exhibit volume will be made as E ____.

omitted was material if it "would or *might*" (emphasis supplied) have affected the reasonable investor, directly contravening this Court's decision in *TSC Industries, Inc.* v. *Northway, Inc.,* 426 U.S. 438 (1976).

3. Whether the trial court's charge improperly implied that the defendants were lying, contrary to this Court's holding in *Quercia* v. *United States,* 289 U.S. 466 (1933), and in conflict with the decisions of the Fifth Circuit in *United States* v. *Cisneros,* 491 F.2d 1068 (1976), and *United States* v. *Fischer,* 531 F.2d 783 (1976).

4. Whether the ruling of the trial court that pleas of two of the defendants in another case, in the Western District of New York, could be used for impeachment—

(a) contravenes the express provisions of Rule 410 of the Federal Rules of Evidence, and Rule 11(e)(6) of the Federal Rules of Criminal Procedure;

(b) is in conflict with the decision of the Fifth Circuit in *United States* v. *Morrow,* 537 F.2d 120, *rehearing denied,* 541 F.2d 282 (1976), *cert. denied,* 430 U.S. 956 (1977);

(c) is contrary to this Court's decision in *Loper* v. *Beto,* 405 U.S. 473 (1972).

—particularly when the pleas were later authorized to be withdrawn by the court in the Western District on the ground that the prosecution had withheld exculpatory material in violation of *Brady* v. *Maryland,* 373 U.S. 83 (1963).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional and statutory provisions involved in this petition are quoted in full in Petitioners' Appendix E.[2]

STATEMENT OF THE CASE

Petitioners were indicted in the Southern District of New York on nine counts, eight counts charging mail and securities fraud, and one count alleging conspiracy to defraud by the means alleged in the other eight counts.[3]

Petitioners David Stirling, Jr. and his younger brother, William, had been carpenters and house builders in Canada. They immigrated to the United States and became construction contractors in upstate New York, doing business as the Stirling Brothers, Inc. Neither had more than a tenth grade education. In 1968, the Stirlings (and two others) incorporated Stirling Homex Corporation ("Homex") and placed its stock privately. The corporation was formed to develop the Stirlings' idea of mass producing prefabricated modules for apartments on a factory production line for shipment to a building site where the modules would be combined into single or

[2] See *infra* pp. 71a-77a.

[3] The indictment alleged fraud in the sale of securities of the Stirling Homex Corporation ("Homex"), in violation of 15 U.S.C. §§ 77q(a) and 78ff; that false statements in the filing of a 1971 Registration Statement for the sale of these securities had been made, in violation of 15 U.S.C. § 77x; mail fraud, in violation of 18 U.S.C. § 1341; that false information had been provided to the government in violation of 18 U.S.C. § 1001; and that petitioners had violated 18 U.S.C. § 371, by conspiracy to violate the statutes cited above. The indictment is set forth in Pet. App. D. pp. 59a-70a.

multi-family homes. This mode of production was both faster and less expensive than the traditional method of on-site construction. David Stirling, Jr., became chairman of the board of Homex and its chief executive officer. William Stirling became president and a director.

Petitioner Harold M. Yanowitch had practiced law in Rochester with a three-man firm. He was engaged in a general practice with emphasis on real estate, and was not knowledgeable about the securities laws. He met the Stirlings through doing their personal legal work. Mr. Yanowitch joined Homex as general counsel and vice president in 1969.

Initially, Homex modules were sold primarily to residential projects being developed by the Stirlings. With the increased availability of federal funds for housing projects and increased demand for the modules, it became apparent that Homex should seek public financing and government contracts in order to expand the business. Petitioners engaged outside and in-house experts to assist them with the accounting,[4] labor[5] and Securities and Exchange Commission ("SEC")[6] problems raised by being a new company in a new industry.[7]

[4] Harris, Kerr, Foster & Co. ("HKF") was the accountant for Homex until 1971, when Merrill Lynch, then the underwriter for Homex preferred stock, requested the retention of a "Big Eight" accountant. Peat Marwick Mitchell & Co. ("PMM") then replaced HKF. Professor Joseph A. Mauriello of the New York University School of Business Administration served as an accounting consultant.

[5] Theodore W. Kheel, a labor lawyer of national reputation, was a member of the board of directors, and served as the expert on labor relations.

[6] The law firm of Shea, Gould, Climenko & Kramer, specifically senior partner Allan Kramer, served as the expert on SEC matters.

[7] In-house counsel knowledgeable in securities regulation, government contracts and housing development programs were also hired.

Homex filed a registration statement with the SEC in October, 1969, which was amended in 1970. It covered 1,175,000 shares of Homex common stock. Stock was first offered for public sale in 1970 at $16.50. At the end of the first day of trading the stock closed at $34 per share, and after six weeks, rose to $52 per share. In July, 1971, Homex filed a registration statement with the SEC for 500,000 shares of preferred stock, and issued a prospectus in August, 1971. Later that year, Homex filed its annual report for 1971, which, along with a quarterly report, was also sent to shareholders.

In essence, the indictment derives from the fact that stock in Homex was offered to the public in 1971, rose and fell in price, and that in 1972, when various banks called in their loans, Homex was bankrupt.

The central issue at trial was whether Homex labor relations, land transactions, and module sales were honestly characterized by petitioners in Homex statements and reports. The petitioners contended that they tried in good faith to provide adequate disclosure and had relied on experts in the fields of accounting, labor relations, and securities laws to determine proper characterization under the circumstances. The government on the other hand focused mainly on omissions from the information provided in contending that the petitioners had willfully set out to deceive their experts as well as the public. (The record is devoid of proof that petitioners ever refused information sought by the experts.) The main areas of factual contention are summarized below, and the government's contentions in regard to them are noted, in order to provide a background for assessment of the legal issues presented herein.

(1) *Stock Purchases by Union Officials.*

In June, 1969, Homex entered what the undisputed testimony established was an arm's length agreement[8] fairly negotiated with the United Brotherhood of Carpenters and Joiners of America ("UBCJA") for in-plant production and on-site installation of Homex modules. (A. 448). The president of E. M. Pressprich Co., the underwriter for the initial Homex stock offering, testified that in approximately January, 1970, David Stirling requested that some people, including representatives of labor unions, be added to the original stock issue list, and that when he was told this was not appropriate, Stirling dropped the subject.[9] (A. 175, 176, 180).

The Homex prospectus, issued in February, 1970, stated:

> "Freedom from work interruptions as a result of labor problems is important to the continued success of the Company's business. Although the Company believes that the above-mentioned agreements should contribute to the continuation of its present satisfactory labor relations, *it can give no assurance that the Company and its subsidiaries will be free of labor problems in the future.*" (E. 51-52; emphasis added.)

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[8] The government devoted great effort at trial and on brief below to cast suspicion on Homex labor relations, but virtually all of the evidence related to the period well before any stock sales to union officials had taken place or there was any allegation of an improper relationship.

[9] No UBCJA official ever bought Homex stock at the $16.50 original issue price, or below.

The government alleged that this statement in the prospectus was materially misleading because it failed to disclose that labor relations might be affected by unrevealed relationships with union officials, particularly that, after the initial sale of Homex stock, David Stirling had arranged for bank loans to be made to union officials to enable them to purchase Homex stock. (See Indictment, Pet. App. D, pp. 59a-70a.)[10]

The government's theory in this connection rested on three contentions: (1) that after the initial issuance of stock, David Stirling had asked if it would be proper for union officials to purchase stock at the after-market price, and when told by the underwriter's president that this was permissible, asked him to arrange the sale; (2) that David Stirling arranged for and personally guaranteed the bank loans to union officials to purchase the stock; and (3) that failure to disclose these purported transactions was materially misleading and violated the securities laws. However, David Stirling denied requesting the stock purchases or guaranteeing the loans. (A. 454, 457.) He further testified that Homex' labor expert, Theodore Kheel, told him such purchases were not unlawful and that Kheel himself designated union officials to receive Homex stock.[11]

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[10] Petitioners, prior to trial, pursuant to Fed. R. Crim. P. 7(d), moved to strike this count on the grounds that it was immaterial, inflammatory, and prejudicial. The motion was denied.

[11] The petitioners contended that Mr. Kheel had endorsed and, in part, directed the sales of stock to union officials. Mr. Kheel denied this on rebuttal, but, Joseph Lane Kirkland, an official of the AFL-CIO directly contradicted Mr. Kheel's testimony and an official of the UBCJA was prepared to testify to the same effect: that Kheel had personally urged them to take the stock, assured them there was no conflict of interest and personally arranged the purchases.

Six labor union officials testifed.[12] No union official said that Homex received special treatment by virtue of his stock holdings;[13] the government did not present any evidence linking the stock purchases to Homex's actual labor relations or any impact on corporate operations or profits.

Five months prior to the filing of the indictment, in January, 1976, David Stirling and Harold Yanowitch pleaded in connection with a separate indictment in the Western District of New York based on these stock transactions, respectively, guilty and nolo contendere, to charges of violating section 186 of the Taft-Hartley Act for "having caused things of value to be given to" union officials.[14] One month before trial in the present case, petitioners were permitted to examine the grand jury testimony in the Western District, and one day before trial were provided with some critical SEC testimony. On the basis of this evidence, and still prior to trial below, petitioners had moved to withdraw their pleas on the ground that the prosecution had withheld exculpatory material which created reasonable doubt of their guilt, in

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[12] Five stated they had not discussed purchasing Homex stock with any of the petitioners. (A. 182-184, 198-199, 201-202, 205-206, 209-212.) One testified that he had a discussion with the Stirlings, but that he had no financial or stock dealings with them. (A. 183, 190-191, 203-204, 208.) The one Stirling-Homex official about whom there was any testimony concerning dealings with officials of the international union in regard to stock purchases was not called by the government.

[13] The government did present instances of union cooperation with Homex—largely appearances before bodies of local government—(GX 734), but the union officials testified that the cooperation in question, which preceded any stock purchase by more than two years, was in the union interest to alleviate chronic winter unemployment.

[14] David Stirling and Harold Yanowitch were sentenced and fined.

violation of *Brady* v. *Maryland*, 373 U.S. 83 (1963). At trial, over objection, the trial court ruled that the prosecution could use these pleas in cross-examination of David Stirling and Harold Yanowitch, and the government did so in regard to David Stirling.[15]

(2) *Three Land Sales.*

In the early stages of Homex's development, the Stirlings and Homex were, as noted above, involved in changing the nature of their business from developing residential projects on their own land to sale of the modules to developers or development authorities. In order to do so, Homex sold three parcels of property to development corporations on a small downpayment, deferred payment basis. Although Homex clearly noted in its registration statements and reports the extraordinary nature of any such sales in terms of impact on corporate profits, and the deferred payment terms of the sales,[16] these sales were the other principal focus of the government's contentions of inadequate or misleading disclosure.

In each instance, the government contended that the transactions were shams, or "options," with no real purchaser obligation to pay because (1) the purchasers were shell corporations; (2) the downpayments were between 10% and 20% of the purchase prices; (3) principal payments were deferred; and (4) there were purportedly various side arrangements between Homex and the purchasers to induce and motivate purchase. (For example,

[15] Petitioner Yanowitch elected not to testify on this issue as a result of the trial court's ruling that his contested nolo contendere plea was admissible against him.

[16] The registration papers stated that "the Company does not anticipate that land sales will be a significant part of its business in the future." The deferred payment aspects of the sales were revealed. (E. 10 [GX 1], E. 87 [GX 8], GX 10 at 8.)

Homex had in connection with one sale agreed to build modules on the property at list price (A. 387); in connection with another, Harold Yanowitch purportedly told the purchasers he would help them find a buyer if the deal did not develop as planned (A. 230); and in connection with a third, David Stirling told the purchasers "you won't get hurt by this deal" (A. 237a) after the agreement was made (A. 265-66).)

The petitioners presented evidence of the bona fides of the sales, including testimony from purchasers, appraisals, and evidence of consultation with experts,[17] and offered to present evidence that the terms were the usual and customary terms in development contracts.[18]

(3) *Mississippi Sales.*

The government alleged that Rubel L. Phillips, an attorney in Mississippi for Homex, forged a $15 million commitment letter from the Farmers Home Administration (FMHA) to Greater Gulf Coast Housing Development Corporation, a Missouri non-profit corporation, in connection with Greater Gulf's purchase of Homex modules. The commitment letter was "signed" by William T. Richardson, FMHA's assistant state director for Mississippi. Phillips denied knowing the letter was forged; his secretary, who was alleged by Richardson at trial (contrary to his earlier testimony to the SEC) to have signed it, denied doing so.[19] The Mississippi sales of Homex modu-

[17] It was the government's theory that the experts were misled, but see A. 311-14 (testimony of a Homex attorney, and prosecution witness, who dealt with Peat Marwick and Professor Mauriello that he was never instructed to withhold information).

[18] The trial court excluded this evidence over objection. A. 320-325.

[19] No evidence linked William Stirling in any way to the letter; David Stirling and Harold Yanowitch knew of the existence of the letter but had no reason to question its genuineness.

les purportedly resulting from the forged commitment letter were argued to have been improperly included in Homex financial and registration statements.

(4) *Accounting Methods.*

The government contended that the accounting on which the Homex registration statements and reports were based was misleading and inadequate. Specifically, the government alleged that filings with the SEC of statements recognizing income when modules were assigned to a specific contract were misleading, because, according to the prosecution, the assignments had been cancelled, revised or reassigned from project to project. The issue was whether the proper practice of assignment had been abused. (Indictment, Pet. App. D, pp. 59 a-70a). Dr. Mauriello testified for the prosecution that it was permissible accounting practice to reassign modules until the last day of the quarter at which time the assignment of a module to a contract had to become set. A. 368. A prosecution witness also testified that Peat Marwick had seen all entries as to reassignments, each of which, by footnote, was shown to be a reassignment of the module. A. 345-347.[20] The actual auditing partner of Peat Marwick was never called as a witness.

[20] The balance of the indictment involved three charges: (1) an overstatement of 1970 earnings resulting from not including a cost overrun; (2) improper recording of a fee due Greater Gulf from U.S. Shelter Corporation, a Homex financing subsidiary, and (3) inclusion of an expenditure for the preparation of a plant in Mississippi which ultimately was not built. No testimony showed that petitioners had any knowledge of these matters, and a Peat Marwick partner testified that the latter charge involved no impropriety.

Petitioners, after a jury trial, were convicted on all of the nine counts in the indictment. On appeal, the United States Court of Appeals for the Second Circuit affirmed the convictions.

INTRODUCTION

The several issues involved in this case and their overall impact on the ultimate fairness of the trial as it was conducted in the district court make it impossible to prepare this petition in the brief compass usually found in petitions for certiorari. In this situation, the reasons for granting the writ are presented as concisely as possible while adequately setting forth the issues which the petitioners believe make this case worthy of review.

As an aid to the Court, however, a "Summary of Reasons for Granting the Writ" is included preceding the more complete discussions.

SUMMARY OF REASONS FOR GRANTING THE WRIT

The ultimate issue in this case is whether, under all the circumstances, the petitioners have had a fair trial. The several errors which were made at the trial present novel, significant and recurring issues concerning proper construction of the securities law, proper appreciation of petitioners' constitutional protections against double jeopardy and self-incrimination, and proper protection of petitioners' presumption of innocence. Each of these errors standing alone presents a significant issue, worthy of review. However, even if no one of these questions alone would be worthy of review, their cumulative effect,

it is submitted, was to deprive the petitioners of a fair trial by inflating the petitioners' alleged violation of the Taft-Hartley Act into a basis for a criminal fraud conviction under the securities and mail fraud statutes.

Petitioners were convicted below for not disclosing, or inadequately disclosing, their relationship with union officials, specifically, giving things of value to union officials, an offense for which two of the petitioners were charged in a separate proceeding in the District Court for the Western District of New York. The government contends that the undisclosed particulars of Homex labor relations were "material" to the investing public, and thus that the petitioners had to make a confession in securities filings of all that they had done. The government also contends that, once convicted of Taft-Hartley violations, the petitioners could be convicted again for failing to reveal them. The government contends further that petitioners' pleas of guilty and nolo contendere with regard to the Taft-Hartley violations can be used for impeachment although the pleas were improperly obtained. To support the decision and conviction below the government must be right on each of these points, but it is wrong on every one.

1. The courts below never faced the crucial issues in the proper construction of the securities statutes which make a "material" omission the basis for a criminal charge. In particular, the court gave no weight to the long established rule that a criminal statute should be construed in such a way as to eliminate serious constitutional doubt.

(a) Under *California* v. *Byers*, 402 U.S. 424 (1971), when an individual constitutional claim

against self-incrimination is confronted by a regulatory need for information, the interests of the individual and the government must be assessed, balanced, and reconciled. The courts below failed to accord proper importance to the constitutional issues and badly misconceived the weight of the regulatory interest.

The conviction below nullifies the petitioners' privilege against self-incrimination by holding that the federal securities statutes require a direct confession of crime without an adequate regulatory justification, or any protection of petitioners' interest, such as use immunity. Compare *United States* v. *Freed*, 401 U.S. 601 (1971) (use immunity provided in statute).

(b) Basing materiality, the gist of the offense under the securities statutes, on the illegality under Taft-Hartley of petitioners' labor relations, makes the securities "fraud" the same offense as the Taft-Hartley violation in the terms of double jeopardy established in *Brown* v. *Ohio*, 432 U.S. 161 (1977). The fact that the alleged securities offense is totally derivative from the Taft-Hartley offense emphasizes both the superfluousness and the unfairness of securities prosecution under these circumstances.

2. There was no proper finding that the information at issue here was material. (a) The trial court's instruction flatly contravenes this Court's holding in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), by allowing the defendants to be convicted if information which was not detailed in materials filed with the SEC or sent to shareholders "would or *might*" (emphasis supplied) have affected the reasonable investor. (b) The court of appeals apparently took the view that any illegality was material

per se under the securities laws. This approach makes securities disclosure into an inquisitorial device, and grants to the SEC the authority which this Court denied to a regulatory agency, in another context, in *NAACP* v. *Federal Power Commission,* 425 U.S. 662 (1976): the power to enforce other statutes not directly related to the agency's charter on the basis of its conception of the public interest.

3. The trial court's improper instruction on credibility of witnesses and reliance on experts deprived the petitioners of their proper presumption of innocence, placed the government's burden of proof on the petitioners, and allowed the defendants to be convicted on the basis of good faith reliance on and good faith disclosure to experts.

(a) The charge to the jury improperly implied that the defendants in the case were lying, in contravention of this Court's holding in *Quercia* v. *United States,* 289 U.S. 466 (1933), and in conflict with the holdings of the Fifth Circuit in *United States* v. *Cisneros,* 491 F.2d 1068 (1974), and *United States* v. *Fischer,* 531 F.2d 783 (1976).

(b) The charge to the jury by the trial court held the petitioners to expert knowledge of securities, labor, and accounting requirements by charging that they were strictly liable for complete disclosure of "material" matter to their experts and lawyers, though any omissions may have been innocent, or the petitioners may have lacked the expertise to recognize the materiality of their knowledge. *United States* v. *Crosby,* 294 F.2d 928 (2d Cir. 1961), *cert. denied sub nom. Mittleman* v. *United States,* 368 U.S. 984 (1962). Securities markets cannot function properly if one cannot rely on experts in attempting to comply

with complex legal requirements. *Cf. Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).

4. The ruling of the trial court that Harold Yanowitch's plea of nolo contendere and David Stirling's plea of guilty, entered in the Western District, could be used for impeachment (a) contravenes the provisions of Fed. R. Evid. 410 and Fed R. Crim. P. 11(e)6, (b) results in a conflict not only with these federal rules, but also with the holdings of the Court of Appeals for the Fifth Circuit, and (c) conflicts with this Court's holding in *Loper* v. *Beto,* 405 U.S. 473 (1972). The "manifest injustice" of using a plea obtained in violation of *Brady* v. *Maryland,* 373 U.S. 83 (1963), as the pleas here were, is just as compelling when the pleas are used in collateral proceeding involving the same offense.

REASONS FOR GRANTING THE WRIT

1. *The conviction below erroneously construed the basic provision of the securities statute so that it (a) violates the petitioners' right against self-incrimination because they have been convicted of failure to make a direct confession of crime, and (b) violates the double jeopardy clause because two of the petitioners were tried twice for the same offense.*

The basic statute involved here is 15 U.S.C. §77q which makes unlawful an "omission to state a material fact." The meaning of "material" in this context is an important question of construction which is controlling in this case. In the absence of more specific language, the statute should not be construed in a way that raises

substantial constitution questions. As this Court said in *International Association of Machinists* v. *Street*, 367 U.S. 740, 749-750 (1961):

> "Federal statutes are to be construed so as to avoid serious doubt of their constitutionality."

This is particularly true in the case of a penal statute.[21]

The defendants were convicted below in large part on the basis of their failure to reveal "giving things of value" to union officials, in materials filed with the SEC and mailed to investors.[22] The court of appeals below has held that the impropriety of these payments makes them material and thus that failure to disclose the situation made the Homex representations about labor relations materially misleading.[23]

(a) *The construction given the statute by the court of appeals, convicting the petitioners for failure to*

[21] See also *United States* v. *Delaware & Hudson Co.*, 213 U.S. 366, 408 (1901); *Crowell* v. *Benson*, 285 U.S. 22, 62 (1932); *United States* v. *Harriss*, 347 U.S. 612, 618 (1954); *Schneider* v. *Smith*, 390 U.S. 17, 26 (1968).

[22] All nine counts of the indictment alleged the misrepresentation of or failure to disclose the particulars of stock ownership by UBCJA officials as instances of the alleged securities and mail fraud. See Pet. D, *infra*, which sets forth the indictment.

[23] "The true nature of Homex's labor relations was important to a potential investor. Once Homex decided to make representations concerning its labor relations, it should have described them accurately. Corporate funds were being used *improperly* to aid in the maintenance of peaceful labor relations, a fact that investors did not know. Knowledge of the true machinations would have given a prudent investor considerable pause—labor relations would not have looked as *normal* as they were made to appear nor would the corporate financial practices have appeared so *sound*." Pet. App. A., p. 38a; emphasis added.

> *make a direct confession of crime, raises serious questions with respect to their privilege against self-incrimination.*

As this Court pointed out in *California* v. *Byers*, 402 U.S. 424, 427 (1971) (per Burger, C.J., for the plurality):

> "Tension between the State's demand for disclosures and the protection of the right against self-incrimination is likely to give rise to serious questions. Inevitably these must be resolved in terms of balancing the public need on the one hand, and the individual claim to constitutional protections on the other; neither interest can be treated lightly."

Neither the court of appeals below nor the trial court applied this test correctly because both the individual claim and the public need were badly misassessed.

California v. *Byers*, 402 U.S. 424 (1971) makes it clear that the crucial first question in reconciling the right against self-incrimination with the regulatory information needs of the government is the "testimonial" nature of the response required or, in Justice Harlan's analysis, how explicitly incriminating is the response required.[24] Both courts below ignored this issue completely, despite the pretrial motions and repeated arguments of the petitioners.

The *Byers* Court upheld the compulsory reporting scheme at issue there,[25] and Byers' conviction, because of

[24] 402 U.S. at 429-431 (plurality); *id.* at 436, 454-458 (Harlan, J., concurring).

[25] Byers had been prosecuted for refusal to comply with a California statute which required those involved in automobile accidents resulting in property damage to stop and give their names and addresses.

the relative weakness of the personal interest at stake. The admission required only established involvement in an automobile accident, an admission, in effect, of membership in a broad, non-suspect group. The admission was, at most, a "link in the chain" of evidence of possible wrongdoing. 402 U.S. at 427-428. Both the plurality and Justice Harlan's concurring opinion emphasized that the information required did not, considered by itself, establish either the existence of a crime, or the guilt of the information provider.

Here, by contrast, the admission which the petitioners are being prosecuted for not making is a direct admission of criminal behavior under the Taft-Hartley Act: giving things of value to labor officials. The testimonial and incriminating nature of the admission is clear. Moreover, the information is allegedly material *because* it reflects illegal or improper actions.

Where the admission required is direct confession of a crime, it is immaterial to the constitutional inquiry that the disclosure requirements are more broadly directed as well, to other disclosure and less suspect activities.[26]

[26] In *Marchetti* v. *United States*, 390 U.S. 39, 47 (1968), and *Albertson* v. *Subversive Activities Control Board*, 382 U.S. 70, 79 (1965), this Court upheld refusal to comply with regulatory reporting statutes directed at "suspect" classes in an area "permeated with criminal statutes," because compliance would automatically place one in a suspect group. This narrow description of "suspect groups" and "permeated areas" was meant to avert the danger that assertion of a feigned or subjective anticipation of criminal prosecution would allow an individual to insulate himself from prosecution for failure to comply with the regulatory scheme. The *Marchetti* Court did not purport to set out the "indispensable foundation of a fifth amendment claim." *California* v. *Byers*, *supra*, 402 U.S. at 469-471 (Brennan, J., dissenting); *see also*, 402 U.S. at 427, 434 n.6 (Burger, C.J., for the four-justice plurality), and 402 U.S. at 437-438, 454-458 (Harlan, J., *concurring*).

In the present case the individual claim is compelling: the petitioners were convicted of failing to make a direct confession of crime.[27] The regulatory interest in the information involved is the interest in keeping the investing public fully apprised of the "material" facts about publicly held companies. The petitioners provided the fair overall assessment of labor relations when they said that relations were currently stable, but that no assurances about the future of such relationships could be given; nor were any such assurances given at any time. *See* p. 7, *supra*.

The balance of interest, therefore, is between a clear constitutional right not to be required to implicate oneself in crime, and the SEC's interest, or ultimately the interest of the investing public, in the *additional* details of Homex' labor relations. If regulatory interest in additional information is, as in *Marchetti*, "tenuous," because the facts are determined to be not "material" or because the securities laws are being applied beyond their proper bounds, then *Marchetti* should control this case, and the petitioners' Fifth Amendment rights must be vindicated by reversal of

[27] Petitioners do not, of course, contend that disclosure requirements of the securities law are universally or even generally invalid or inquisitorial, or that, as the court of appeals below colorfully put it, "securities misrepresentations would be constitutionally protected if the true but undisclosed facts would lead to criminal prosecution." Pet. App. A. p. 34a. The position here is far more narrow. The petitoners do not controvert their duty under the securities laws not to make misrepresentations of material fact. But the petitioners assert that their representation of labor relations was *true*, if not comprehensive in detail. The question is whether additional detail may be held "material" simply because it is criminal, and whether it is necessary or appropriate to impose criminal penalties under the securities laws as well as corporate liability, personal civil securities liability, and criminal liability for the substantive undisclosed offense.

the conviction below. If on the other hand, the regulatory interest in the additional information were to be determined to be a strong one, then this is a case of first impression in which this Court must reconcile compelling Fifth Amendment considerations and strong regulatory interests.

(b) *The construction of the statute adopted by the court of appeals placed Harold Yanowitch and David Stirling in double jeopardy contrary to the Fifth Amendment, and Brown v. Ohio, 432 U.S. 161 (1977).*

At the time of the trial below, David Stirling and Harold Yanowitch had pleaded guilty to Taft-Hartley violations in the separate proceeding in the Western District of New York. Specification of nondisclosure of the petitioners' union activities, as a means of fraud, when they had already been separately convicted of Taft-Hartley violations based on those activities, violates the double jeopardy provision of the Fifth Amendment, and is in direct conflict with the principles of *Blockburger* v. *United States*, 284 U.S. 299 (1932), and *Brown* v. *Ohio*, 432 U.S. 161 (1977).

The *Blockburger* rule, as initially stated and affirmed throughout the years, states that a defendant cannot be put twice in jeopardy for the same actions unless *each* crime of which the defendant is charged requires proof of an element not required for the other crime. 284 U.S. at 304. *Brown* v. *Ohio* affirmed this test and made it clear that it precludes separate prosecutions of a defendant for both a greater and a lesser included offence. *See also Harris* v. *Oklahoma*, 433 U.S. 682 (1977).

In functional terms, this is precisely the situation here. The petitioners were convicted by plea of violation of the

Taft-Hartley Act. They were tried below for failing to disclose that violation. While the fraud judgment below required elements of proof which were not required in the previous prosecution, the previous prosecution did not involve any elements which were not involved in the prosecution below. The labor union relations of Homex are allegedly "material" precisely because they were illegal or improper, as established by the Taft-Hartley Act violation. Since the SEC offence is totally derivative of the Taft-Hartley offence, the government has attempted "to secure additional punishment after a prior conviction and sentence." 432 U.S. at 166.

The device of resting the materiality of actions on their illegality means that every time a corporate misdemeanor is committed, the officials responsible are to be prosecuted once for doing it and once for failing to confess in documents required to be filed with the SEC. In this case for example, failure to confess a misdemeanor makes each of the petitioners a felon. This is a stiff price tag for failure to make a confession that is only arguably material.[28]

The court of appeals below ignored the inquiries established as relevant in *Blockburger* and *Brown* in favor

[28] The government argued in its brief before the court of appeals that petitioners had waived any double jeopardy claim. Govt. Br. at 84. Even if there was such a waiver of the double jeopardy claim in itself this should not erase double jeopardy issues insofar as they are relevant to sound construction of the securities statutes, the point pressed here. Moreover, although the petitioners did not claim double jeopardy at the time of their indictment, David Stirling's counsel did move for mistrial on the basis of the prejudicial effect of the allegations of Taft-Hartley violations (A. 459-468) at the later time when it became clear that the illegality of Homex's labor relations was the sole basis for the government's contentions concerning materiality. It was only then that the double jeopardy involved became clear.

of a mechanical recitation that for double jeopardy to attach the offences charged must be the "same in fact and law." (Pet. App. A, pp. 36a-37a). As *Brown* makes clear the required double jeopardy inquiry is not so restrictive.[29] Plenary review is required not only to prevent prejudice to petitioners and subversion of the securities laws, but also to elucidate the reach of this Court's recent holding in *Brown.*

2. *There was no proper finding of materiality, and the conviction of petitioners is an improper expansion of the criminal jurisdiction of the securities laws.*

"Materiality" of disclosures and nondisclosures is the crux of the petitioners' alleged liability under the federal securities laws. But both the trial court and the court of appeals misapplied the concept in a way which is directly in conflict with this Court's recent decision in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976).

(a) *The instruction was erroneous:* The jury was repeatedly instructed that it could find a statement or omission material if it "would or *might*" (emphasis supplied) have induced an investor to act or not act.[30]

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[29] Compare this Court's statement in *Brown*, 432 U.S. at 164:

> "It has long been understood that separate statutory crimes need not be identical—either in constituent elements or in actual proof—in order to be the same within the meaning of the constitutional prohibition. 1 J. Bishop, New Criminal Law § 1051 (8th ed. 1892); Comment, Twice in Jeopardy, 75 Yale L.J. 262, 268-269 (1965)."

[30] "This means that if you find a particular statement of fact to have been untruthful or a particular omission to be such that it made statements untruthful, before you can find that statement or omission to be material you must

footnote continued

As Justice Marshall said in the *TSC* case (426 U.S. at 448-449), relying on Judge Friendly's leading Second Circuit opinion in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1301-1302 (2d Cir. 1973):

> "The potential liability for a Rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholder in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking. Precisely these dangers are presented, we think, by the definition of a material fact adopted by the Court of Appeals in this case—a fact which a reasonable shareholder *might* consider important. We agree with Judge Friendly, speaking for the Court of Appeals in *Gerstle*, that the

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footnote continued

also find that the statement or omission was of such a nature that it *would or might* reasonably have induced the person to act or not to act, and in this case specifically to purchase or not to purchase the stock of Stirling Homex.

"As I say, the same is true with statements and with omissions. If you find that information which was withheld or omitted would, if disclosed, have significantly changed the nature of the information that was given and would have changed the information so that the effect on the decision to act or not to act *would or might* have been different, then the omission was material.

"If you find that the addition of the omitted information wouldn't have made any difference, then you may not find that the omission was a material one." (Emphasis added.) A. 597-98.

"might" formulation is 'too suggestive of mere possibility, however, unlikely.' 478 F.2d, at 1302."[31]

The instruction below—which related to all of the securities counts and all the alleged "means of fraud" and representations of the petitioners—was plain error. It was clearly prejudicial for the reasons set forth in the *TSC* and *Gamble-Skogmo* opinions: this formulation of materiality allowed the petitioners to be convicted on a "mere possibility" that the nondisclosures in question would have affected a reasonably prudent investor.[32] Review by this Court is necessary because affirmance of such an instruction erodes the holding of *TSC* and dramatically escalates the risks of entering the market for capital.

(b) *Illegality is not material per se*: The government has in effect urged, and the court of appeals below adopted, a *per se* definition that illegality or impropriety by management relating to the sale or issuance of stock is necessarily "material." This position is directly in conflict with this Court's recent holdings in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), and *NAACP* v. *Federal Power*

[31] Although the *TSC* case dealt specifically only with materiality as it related to proxy solicitations, the basic reasoning of the Court would seem applicable to materiality generally as that issue arises under the securities acts, and particularly in a criminal provision of those acts. See also American Law Institute, Federal Securities Code—Proposed Official Draft, § 293 at 125-126 (March 15, 1978) adopting the *TSC* definition as the general definition of materiality.

[32] In the absence of a proper instruction based on the *TSC* formulation of materiality, there is no proper finding on this record that the facts in question were indeed material. The prejudice to the rights of the defendants on all counts of the indictment in question is direct and compelling, and the regulatory interest in requiring the disclosure has simply not been adjudicated or established.

Commission, 425 U.S. 662 (1976), affirming 520 F.2d 432 (D.C. Cir. 1975).

In the *TSC* case this Court overturned a summary judgment on the issue of materiality and held that materiality must be assessed as a factual matter in light of all the circumstances.[33] A flat holding that the illegality of the petitioners' conduct is material as a matter of law would be improper in any case and is doubly so in a criminal case.

In this case, as the opinion of the Second Circuit below makes clear, it is the "impropriety" of the facts "withheld" by the petitioners (as measured by other statutes or by the general public interest), not their economic size or any concrete, undisclosed impact on corporate operations, which renders them "material" for disclosure purposes. See p. 18, n.23, *supra*. The SEC's authority to compel disclosures—based on the need to ensure a free flow of information, and protect the reliabi-

[33] "In considering whether summary judgment on the issue is appropriate, we must bear in mind that the underlying objective facts, which will often be free from dispute, are merely the starting point for the ultimate determination of materiality. The determination requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are 'so obviously important to an investor, that reasonable minds cannot differ on the question of materiality' is the ultimate issue of materiality appropriately resolved 'as a matter of law' by summary judgment. *Johns Hopkins University* v. *Hutton*, 422 F.2d 1124, 1129 (C.A.4 1969). See *Smallwood* v. *Pearl Brewing Co.*, 489 F.2d 579, 604 (C.A.5 1974); *Rogen* v. *Ilikon Corp.*, 361 F.2d 260, 265-267 (C.A.1 1966)." 426 U.S. at 450.

lity of capital markets—is expanded to include authority to enforce other criminal statutes by self-reporting.

But a general admonition to promote the public interest in a grant of regulatory authority does not give an agency full license to pursue "public interest" issues not entrusted to its jurisdiction by statute. In *NAACP* v. *Federal Power Commission, supra,* this Court rejected the NAACP's attempt to force the FPC to adopt anti-discrimination rules for its regulatees, and a complaint and enforcement scheme to implement such rules. The FPC was held to be properly concerned with discrimination issues only so far as they had an impact on fair and reasonable electricity rates or other explicit statutory duties of the Commission.

The SEC itself has in the past rejected broad authority to promote aspects of the public interest which are unrelated to the protection of investors, for reasons similar to those set forth in *NAACP* v. *Federal Power Commission.*[34] Almost three years after the Homex prospectus was filed in July 1971, the SEC was still taking the position that while a conviction for illegal contributions to a political campaign was a material fact, the "disclosure of campaign contributions that may be illegal but have not yet become the subject of a formal proceeding" could be left to the discretion of management. See SEC Securities Act Release No. 33-5466 [1973-74 Transfer Binder] CCH Fed. Sec. L. Rep. ¶79,699 (March 8, 1974). See Note,

[34] As recently as 1975, the SEC stated that the existence of a statutory framework prohibiting certain types of corporate conduct did not mandate disclosure of the corporation's failure to comply with those statutes. See SEC Securities Act Release No. 33-5627, [1975-76 Transfer Binder] CCH Fed. Sec. L. Rep. ¶80,310 (October 14, 1975). Significantly, one of the items rejected as a per se subject of disclosure was "compliance with the Fair Labor Standards, Occupational Safety and Health and National Labor Relations Act." *Id.* at 85,724, n.72.

Disclosure of Corporate Payments and Practices: Conduct Regulation through the Federal Securities Laws, 43 *Brooklyn L. Rev.* 681 (1977). The petitioners are being held criminally liable for not complying with a dubious notion of materiality which the SEC has itself rejected.

The recent Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission (1977)[35] (A. Sommer, ex-commissioner, Chairman) is clear and emphatic that attempts to broaden the purview of the SEC in the manner presented in this case are inconsistent with its authority and destructive of its function. In the recommended statement of objectives for the Commission, the concluding statement is (p. 307):

> "The Commission should not adopt disclosure requirements which have as their principal objective the regulation of corporate conduct."[36]

[35] The Advisory Committee on Corporate Disclosure was appointed by the SEC itself to undertake a thorough study of the SEC's responsibilities and functions in the area of disclosure. Its report was based on twenty-one months of effort by the 17 appointed experts (later 16 with the appointment of Harold Williams to be Chairman of the SEC) supported by SEC staff and resources. The report has been submitted to both the SEC and the House Committee on Interstate and Foreign Commerce.

[36] The Committee emphasized that the SEC should not put itself in the position of arbitrating among the interests which seek information beyond that which is relevant to investment or suffrage decisions. It said (id. at 312):

> "This is a role the Commission is neither authorized nor qualified to fill."

Moreover, attempting to satisfy all these interests would result in the useless "avalanche" of trivia which this Court feared in *TSC. Id.*

See also Sommer, "The Slippery Slope of Materiality," P.L.I Address, at 21, 1975: "If the enforcement of the disclosure laws becomes in effect a substitute for the enforcement of other substantive laws, then I would suggest that the Commission will have been diverted from its true mission. . ."

The costs, therefore, of the sort of disclosure requirement at issue here include impact on the proper statutory functions of the SEC. as well as upon the individual rights of the petitioners. *See also,* Mann "Watergate to Bananagate: What Lies Beyond," 31 Bus. Lawyer 1663 (1976).

3. *The charge to the jury on credibility of witnesses and reliance on experts was in conflict with the presumption of innocence, and the scienter requirements of the securities laws.*

(a) *The trial court's charge to the jury improperly implied that petitioners had committed perjury, and thus were guilty.*

In the charge to the jury in regard to the credibility of witnesses, the trial court stated:

> "Now to go to a subject much less technical and perhaps much more critical in the end, the subject of credibility of witnesses. That is a key problem for juries. *I think it is reasonably safe to suggest that you probably heard more than once perjury from the witness stand in this case.* Beyond that, of course, you have heard lots of conflicting statements about what happened or didn't happen, about what was said or was not said, and you are relying on the net effect of those witnesses in the last analysis for your discovery of the truth, for your accurate recreation of the events upon which you will base an accurate and just decision, and that is the problem of credibility." (A.657; emphasis added.)

The trial court went on to imply further that the anonymous perjurers were in fact the petitioners:

> "Among interested people who testified you have heard three of the defendants themselves,

> and you would know without my saying that a defendant in a criminal case has a deep and profound and abiding interest in the outcome of that case. Obviously that is among the factors you will take into account in appraising the credibility of those witnesses." (A.659-60.)[37]

The court below held that because no objection had been raised by petitioners to the charge, the issue could not be raised on appeal, but that in any event, the instruction was fair and proper and not plain error. (Pet. App. A, p. 49a.) This conclusion is incorrect.[38] In addition, it conflicts with the principles of *Quercia* v. *United States,* 289 U.S. 466 (1933) and the view taken by the Fifth Circuit of the extent to which a trial court may comment on the veracity of a defendant's testimony without causing

[37] The trial court implied that witnesses who had been given immunity would, in contrast to the defendants, be particularly truthworthy witnesses. The court charged:

> "In considering whether they may have sworn falsely in this respect, you may also take into account that the cases at least where immunity has been granted, the immunity has been conditioned on the undertaking of the witness to tell only the truth here and elsewhere with the stipulation that the immunity would end if the person was deemed to testify falsely, and you may weigh that with and against the several other things that I have mentioned." (A.660-61.)

[38] The cases relied on by the court below support the proposition that an instruction which points out the defendant's interest in the outcome is not necessarily unfair in itself; those cases do not reach the impact of such an instruction when given in close conjunction with a suggestion of perjury and an emphasis on the agreement of the immunized witnesses to testify truthfully. Pet. App. A., p. 49a.

the defendant to lose the presumption of innocence to which he is entitled.[39]

As this Court noted in *Quercia* v. *United States,* 289 U.S. 466, 470 (1933), "hostile comment of the judge should not render vain the privilege of the accused to testify in his own behalf." The Court found that the trial court's comment that the accused's wiping his hands was "almost always an indication of lying" was reversible error, not cured by a cautionary instruction that the jury was not bound by his view of the evidence. 289 U.S. at 472. Because "the influence of the trial judge on the jury 'is necessarily and properly of great weight' and 'his lightest word or intimation is received with deference, and may prove controlling,' " 289 U.S. at 470, quoting *Starr* v. *United States,* 153 U.S. 614, 626 (1894), the effect of the trial court's words was inherently prejudicial to petitioners.

In two recent cases, *United States* v. *Cisneros,* 491 F.2d 1068 (5th Cir. 1974) and *United States* v. *Fischer,* 531 F.2d 783 (5th Cir. 1976), the Fifth Circuit has taken the position that comments by the trial judge that a defendant is not telling the truth require reversal and remand.[40] In *Fischer,* the defendant had testified con-

[39] *See also United States* v. *Goichman,* 547 F.2d 778, 784-785 (3d Cir. 1976), where the court concluded that although there was some doubt, the judge's comment that the reason why the defendant was chosen for prosecution of criminal tax evasion "was simple as ABC" did not constitute reversible error based on the entire record. A remark of this kind is simply not analogous to the instruction here.

[40] In *Cisneros,* the trial judge had stated "somebody is lying." This remark, coupled with a comment on the demeanor of a witness, was too harmful to be cured by a cautionary instruction, particularly when the instruction occurred well before the prejudicial remarks. 491 F.2d at 1075. Indeed, even a comment on defendant's character has been held to constitute plain error. *United States* v. *Musgrave,* 444 F.2d 755 (5th Cir. 1971).

cerning the attire of various individuals at the time of the alleged crime and the trial court charged the jury (531 F.2d at 786):

> "I feel constrained to point out that someone obviously didn't tell the truth from the witness stand in this case. Use your own common sense to aid you in determining who did and who didn't. Consider, if you can remember what you wore a week ago Tuesday, let alone what everyone in the room wore eight months ago when you had reason to remember such details."

The Fifth Circuit held that "the trial judge's comments unduly trespassed upon the jury's function of determining the credibility of witnesses." *Id.*

The conflict between *Quercia, Cisneros,* and *Fischer* [41] on the one hand, and the view of the court below, on the other, can only be resolved by this Court.

(b) *The trial court's instruction on reliance on experts allowed the petitioners to be convicted despite good faith disclosure and good faith reliance.*

It was the prosecution's burden to prove the absence of good faith as a crucial element of the offenses. The instruction on reliance on experts improperly reversed this burden. It deflected the attention of the jury away from the crucial inquiry, the petitioners' willfulness, into an

[41] The trial court in *Fischer* refused to give an instruction that the jury was not bound by the judge's comments, but the absence of this instruction was not dispositive. It is true, however, that the trial court below did tell the jury that nothing he said should suggest how the jury was to decide an issue. However, as in *Cisneros,* that instruction preceded the prejudicial remarks by some 100 pages or two hours. Therefore, under *Cisneros,* the instruction could not cure the prejudice to petitioners of the judge's suggestion of perjury.

erroneous inquiry into the objective completeness of disclosure. The instruction provided:

> "... If an attorney or accountant has a full account of the facts of what you are doing and what you intend to do and then says it is proper, it is lawful, your proceeding on that basis might serve as a strong indication that you were acting in good faith and not in bad faith.
>
> "On the other hand, you will realize that if some of the important facts are misstated to the accountant or lawyer or if some of the important information is withheld or not disclosed, the advice that the accountant or lawyer then gives can hardly be deemed to constitute a basis for claiming good faith in going ahead and acting on the basis of that uninformed and insufficiently implemented advice." (A.601-02.)[42]

The portion of the charge addressed to reliance upon experts failed to encompass the possibility that any "important information" which the petitioners may not

[42] With respect to reliance on experts, the Stirlings and Yanowitch had jointly requested the following charge:

> "You should ask yourself whether it would be likely that he would have personal knowledge of the fact he related or whether it was more likely that he obtained his information secondhand in reliance on the statements and opinions of others who were closer to the pertinent affairs of the company. For example, even if you find that a financial statement which a defendant mailed, or caused to be mailed, was false as charged, if you find that the defendant relied in good faith on the expertise of the accountant who furnished the statement and that he therefore personally believed the statement to be truthful, you must acquit the defendant charged with fraud in that instance." Request No. 21 (A. 145.)

have disclosed was not "withheld," except in the sense that the nonexpert defendants were not aware of its materiality and that Allan Kramer, Peat Marwick, and Th dore Kheel—a labor lawyer and a Homex director at the relevant times—all did not bother to pose the questions that should have been asked.

The petitioners were in effect held to an expert standard of culpability—to know and disclose all relevant facts, even those which they were not aware were relevant.

In *United States* v. *Crosby*, 294 F.2d 928 (2d Cir. 1961), *cert. denied sub nom. Mittelman* v. *United States*, 368 U.S. 984 (1962), the court reversed the conviction of brokers who had relied upon the advice of securities counsel in connection with the sale of unregistered securities, even though the attorneys giving the opinion had not been given all the facts essential to the determination. The court, in terms equally applicable to the case at bar, noted that (294 F.2d at 942):

> "The statutory and administrative regulatory scheme over this area is far from a model of clarity; such a situation is aggravated when, as here, criminal liability is based on the failure to comply with the law. We think it is all too facile an answer for the government to rely on the experience and supposed expertise of these brokers; the fact is that they purported to rely on opinion letters of an attorney, whose expertise is presumed to be even greater."

Criminal intent and not mere innocent misstatement or mistake is required to violate the fraud provisions of the securities laws, *see, e.g., United States* v. *Koenig*, 388 F.Supp. 670,712 (S.D.N.Y. 1974). The instruction below allowed criminal intent to be bypassed.

To maintain a properly functioning securities market, in which businessmen can seek necessary capital with confidence, it is necessary: a) that experts be held to a high standard of competence, and b) criminal charges rest firmly on a finding of willful violation. In *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), this Court rejected mere negligence as a basis for civil liability under Rule 10b-5 for reasons which should apply even more strongly here. This Court (425 U.S. at 214-215, n.33) quoted from Chief Judge Cardozo's opinion in *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 174 N.E. 441 (1931), concerning the hazards of indeterminate liability for negligent conduct

> "The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences."

The instruction concerning reliance on experts presents a novel and recurring issue, resolution of which is necessary for proper interpretation of criminal wilfulness under the securities statutes and for protection of the fundamental concept that defendants are to be presumed innocent.

4. *The ruling of the trial court that Harold Yanowitch's plea of nolo contendere and David Stirling's plea of guilty, entered in the Western District, could be used for impeachment (a) contravenes the provisions of Fed. R. Evid. 410 and Fed. R. Crim. P. 11(e)6, (b) results in a conflict not only with these federal rules, but also with the holdings of the Court of Appeals for the Fifth Circuit, and (c) conflicts with this Court's holding in Loper v. Beto, 405 U.S. 473 (1972).*

The trial court had been apprised that a motion had been made to withdraw David Stirling's plea of guilty and

Harold Yanowitch's plea of nolo contendere in the Western District, which had resulted from the prosecution's failure to provide exculpatory material in violation of *Brady* v. *Maryland,* 373 U.S. 83 (1963), and that this motion was pending before the court in the Western District. On the opening day of trial, the trial court ruled that petitioners' pleas (of nolo contendere and guilty), in regard to the charge that each had caused things of value to be given to union officials, could be used for purposes of impeachment, as "admissions made at the time in direct contradiction to what is being said [by petitioners on direct examination] as prior inconsistent statements."

As a result of this ruling, petitioner Yanowitch did not testify on this issue. Petitioner David Stirling, who did not testify with respect to any specific matters covered by the Western District indictment, denied that he or his brother ever did "willfully, intentionally and unlawfully conspire to or otherwise violate the securities laws of the United States." As a result of the trial court's ruling, the Government was able to ask petitioner Stirling whether, on January 21, 1976 (the day he pleaded guilty) he had admitted causing things of value to be delivered to union officials identified in the Western District indictment. Stirling conceded that he had made this admission on that date.[43] In short, he was forced to admit guilt.[44] Later, after

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[43] The impression on the jury was heightened by the prosecutor's handing the witness a copy of the transcript of the Western District proceeding and asking him to examine it. (Tr. 4186-87.)

[44] Use of the guilty plea of David Stirling to impeach was prejudicial not only to him, but also to William Stirling and Harold Yanowitch, because as alleged co-conspirators, each was bound by the admission of David Stirling that he had caused things of value to be given to union officials. Thus, each of the petitioners could (and did) appeal on this ground. *Bruton* v. *United States,* 391 U.S. 123, 135-137(1968).

the trial below, petitioners' pleas were permitted to be withdrawn pursuant to Fed. R. Crim. P. 32(d), to prevent manifest injustice because the prosecution had violated the standards of *Brady*.[45]

(a) *The ruling below is in conflict with the Federal Rules of Evidence and Criminal Procedure.*

The ruling of the trial court and the use of a plea of guilty or nolo contendere for impeachment contravenes the provisions of Fed. R. Evid. 410 and Fed. R. Crim. P. 11(e)6.[46] See Pet. App. E, pp. 76a-77a.

Any reading of these rules makes clear that a plea of nolo contendere is not admissible. A guilty plea later withdrawn, is also not admissible.[47] In this case, the grounds for withdrawal of the guilty plea existed at the time the ruling of admissibility was made, and the trial court was apprised of the pending motion to withdraw

[45] The government has filed a motion for reconsideration of this ruling which is still pending in the Western District.

[46] The last sentence of each rule does not apply in this case. That sentence refers to the use of "statements" made in connection with pleas. In this case, there were no statements made in connection with petitioners' pleas. Petitioners stated only "I plead guilty" and "Defendant Yanowitch tenders and pleads nolo contendere to those counts." Thus, it was not petitioners' statements, but their bare pleas, that were ruled admissible. The trial court's ruling supports this conclusion. What was ruled admissible were petitioners' "admissions," or, in other words, their pleas. The court of appeals noted only that the pleas and convictions based on them were not admitted as evidence and denied petitioners' motion for dismissal of the appeal without prejudice and for remand. (Pet. App. A, p. 36a, n. 15).

[47] The Joint Explanatory Statement of the Conference Committee, states: "The Conference agrees that neither a plea nor the offer of a plea ought to be admissible for any purpose." H.R. Rep. No. 414, 94th Cong., 1st Sess. 10, reprinted in [1975] U.S. Code Cong. & Ad. News 713-714.

and the grounds for it. The plea was permitted to be withdrawn to prevent the manifest injustice which would have resulted by its use. It contravenes the federal rules cited above to hold, as the court of appeals did, that the plea could be used merely because no ruling had yet been made on its withdrawal.[48] The pleas, which cannot be used to procure conviction in one context because their exclusion was necessary to prevent manifest injustice, cannot be used in another context without manifest injustice.[49]

If guilty and nolo contendere pleas can be used in contravention of Fed. R. Crim. R. 11(e)6 and Fed. R.

[48] It is, of course, highly prejudicial to introduce even a conviction "arising out of the identical factual circumstances and involving many of the identical elements as the offense on trial." *United States* v. *Martinez*, 555 F.2d 1273, 1277 (5th Cir. 1977) (reversible error and abuse of discretion to permit impeachment in charge of conspiracy to distribute cocaine by conviction for aiding and abetting distribution of cocaine.) The court noted that the "defendant's right to have the jury determine that the government has properly proven every essential element beyond a reasonable doubt was improperly prejudiced by the introduction of the former conviction." 555 F.2d at 1276-1277.

[49] It will doubtless be argued that petitioners' pleas were not introduced as evidence against them but were merely used for impeachment of them, pursuant to Fed. R. Evid. 609. Fed. R. Evid. 609 provides that "For the purpose of attacking the credibility of a witness, evidence that he has been convicted of a crime shall be admitted . . . only if the crime (1) was punishable by death or imprisonment in excess of one year . . . or (2) involved dishonesty or false statement, regardless of punishment." The fallacy in this argument is that the rule requires a conviction, and the pleas were withdrawn and the convictions based on them invalidated. *Cf. United States* v. *Franicevich*, 471 F.2d 427, 429 (5th Cir. 1973) (in the interest of fairness, witness permitted to explain that prior conviction, used for impeachment, was though not yet reversed, on appeal.) But see *Kercheval* v. *United States*, 274 U.S. 220, 223 (1927) ("A plea of guilty differs in purpose and effect from a mere admission or an extrajudicial confession; it is itself a conviction.") and *Parker* v. *North Carolina*, 397 U.S. 790, 801 (1970) (" . . . a guilty plea is more serious than a confession because it is *tantamount to a conviction.*") (Emphasis added.)

Evid. 410, the use of plea agreements will be undermined. This is particularly true if a plea withdrawn because of manifest injustice can be used to impeach.

(b) *The ruling below is in conflict with the Fifth Circuit.*

There is a conflict between the circuits in regard to the admissibility of a plea of nolo contendere for impeachment. As shown by this case, despite the fact that a nolo contendere plea is not an admission of guilt,[50] the Second Circuit permits impeachment based on the plea. *See also Pfotzer* v. *Aqua Systems, Inc.*, 162 F.2d 779, 784-785 (2d Cir. 1947). The Fifth Circuit does not. *United States* v. *Morrow*, 537 F.2d 120 (5th Cir.), *rehearing denied*, 541 F.2d 282 (5th Cir. 1976), *cert. denied*, 430 U.S. 956 (1977). Defendants' rights should not vary with the circuit in which they are tried.

In *Morrow*, "the improper introduction of the nolo contendere pleas by the Government had a substantial effect on the deliberations of the jury." 537 F.2d at 145. Thus, the court concluded that, in the circumstances of the

[50] Further, the ruling of the trial court fails to take into account the distinction between a plea of nolo contendere and a plea of guilty. As the Advisory Committee on Rules points out, a plea of nolo contendere "cannot be used against a defendant as an admission in a subsequent criminal or civil case." Indeed, this is the reason for making such a plea. However, the ruling of the court below that the nolo contendere plea was admissible for impeachment as an admission allows what cannot be done by the front door to come in through the back door. It is unwarranted to say that the nolo contendere plea is not an admission and yet to use it to force the admission which it cannot in and of itself be considered. *Cf. Mickler* v. *Fahs*, 243 F.2d 515, 517 (5th Cir. 1957) ("The same reasons which make the evidence of a plea of nolo contendere inadmissible as an admission will exclude it in a jury trial when offered for the purposes of impeachment.")

case, where the evidence was sufficient but not overwhelming, introduction of the nolo contendere pleas was not harmless error.[51]

If introduction of a valid plea of nolo contendere cannot be considered harmless error, *a fortiori*, the decision to introduce an invalid plea, withdrawn because of prosecutorial misconduct and to prevent manifest injustice, must be plain error.

(c) *The ruling below is in conflict with the principle of Loper* v. *Beto.*

In *Loper* v. *Beto*, 405 U.S. 473 (1972), this Court held that the use of a prior void conviction for impeachment purposes to support guilt deprives a criminal defendant of due process of law.[52] Even assuming *arguendo* that it was the conviction rather than the pleas of petitioners that were to be used here for impeachment, these prior

[51] Here, in conflict with the holding of the Fifth Circuit in *Morrow*, the nolo contendere plea was ruled to be admissible and the court of appeals below has explicitly affirmed the ruling as correct without assessing the impact of the error.

[52] The prior invalid convictions were used here as they were in *Loper*, "simply in an effort to convict [defendant] by blackening his character and thus damaging his general credibility in the eyes of the jury." 405 U.S. at 482, n. 11. David Stirling's direct testimony was only that he and his brother did not violate the securities laws. Thus, also like Loper, "this is not a case where the record of a prior conviction was used for the purpose of directly rebutting a specific false statement made from the witness stand." *Id.* The trial court evidently, and erroneously, believed the case was not like Loper but like *Harris* v. *New York*, 401 U.S. 225 (1971), because he stated that:

> "If he [David Stirling, Jr.] is going to say that he didn't do some of the things that he admitted doing before [the Western District], I think I will be disposed to let that admission come in."

convictions were voided because the prosecution had withheld exculpatory material in violation of *Brady* v. *Maryland, supra.* They should therefore not have been used to impeach.

Withholding exculpatory material is a strategem designed to coerce a plea, or confession of guilt, by restricting the information available to the defendant and inflating the appearance of invulnerability of the Government's case so as to make defense seem hopeless; it is as patent a violation of due process as other means of coercion. Thus, petitioners' pleas were not voluntary, but two sets of convictions were based on them and only one set has been voided.

This Court said in *Jackson* v. *Denno,* 378 U.S. 368, 376 (1964):

> "It is now axiomatic that a defendant in a criminal case is deprived of due process of law if his conviction is founded, in whole or in part, upon an involuntary confession, without regard for the truth or falsity of the confession, *Rogers* v. *Richmond,* 365 U.S. 534, and even though there is ample evidence aside from the confession to support the conviction."

The pleas here amounted to coerced confessions derived by withholding exculpatory information, and were inadmissible for impeachment under *Loper.* Were this not so, the Government would be encouraged to violate *Brady,* safe in the knowledge that a conviction so obtained, while it might later be invalidated, could nonetheless be used in a later proceeding "to support guilt."

In *Brady* v. *Maryland,* 373 U.S. at 87, this Court said that:

> "Society wins not only when the guilty are convicted but when criminal trials are fair; our system of the administration of justice suffers when any accused is treated unfairly."

In order to fulfill this mandate of fairness, this Court should review the decision below.

CONCLUSION

For the reasons stated above, the petition should be granted so that the Court on full review may determine the fairness and correctness of the petitioners' trial and resolve the novel and significant issues of securities law, constitutional law, and criminal procedure presented.

Respectfully submitted,

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May, 1978

APPENDIX A

OPINION OF THE COURT OF APPEALS

United States Court of Appeals

FOR THE SECOND CIRCUIT

Nos. 33, 50, 66, 67, 68-September Term, 1977.
(Argued August 29, 1977 Decided February 2, 1978.)
Docket Nos. 77-1140, 1141, 1144, 1177, 1178

UNITED STATES OF AMERICA,
Appellee,

v.

DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBEL L. PHILLIPS,
Defendants-Appellants.

Before:

LUMBARD, OAKES AND MESKILL,
Circuit Judges.

Appeals from judgments entered in the United States District Court for the Southern District of New York, Marvin E. Frankel, *Judge,* after a six-week jury trial, convicting appellants of securities and mail fraud and conspiracy in connection with sales of stock in the Stirling Homex Corporation. The government charged that Homex's reported earnings had been fraudulently inflated and that material information adverse to Homex had been withheld from the investing public. 15 U.S.C. §§77q(a), 77x, 78ff, 18 U.S.C. §§371, 1001, 1341.

All convictions are affirmed.

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MESKILL, *Circuit Judge:*

This is an appeal by David Stirling, Jr., William G. Stirling, Harold M. Yanowitch, Edwin J. Schulz, and Rubel L. Phillips from judgments of conviction entered on March 11, 1977, in the United States District Court for the Southern District of New York, Marvin E. Franke, *Judge,* after a six week jury tiral. Appellants were convicted of securities and mail fraud and conspiracy in connection with sales of stock in the Stirling Homex Corporation ("Homex"). Specifically, appellants were convicted of violating and, under 18 U.S.C. §371, conspiring to violate §§17 and 24 of the Securities Act of 1933, 15 U.S.C. §§ 77q(a) and 77x, and 18 U.S.C. § 1341.

Appellants were also convicted of conspiring to violate 15 U.S.C. §78ff and 18 U.S.C. §1001. We affirm.

Homex manufactured and assembled prefabricated multi-family modular housing. Its operations consisted of mass-producing individual apartment units, or "modules," using assembly-line production techniques, shipping them to a construction site and installing them in a previously-constructed concrete and steel frame so as to form multi-unit apartment buildings. Each of the appellants served Homex in one or more official capacities, and each had a considerable stake in Homex's financial success. David Stirling, Jr., was Chairman of the Board and Chief Executive Officer; he owned approximately two million shares of Homex common stock. William G. Stirling was President, Chief Opearting Officer and a member of the Board; he, too, owned approximately two million shares. Harold M. Yanowitch was Executive Vice-President, Chief Legal Officer and a member of the Board; he owned approximately 160,000 shares. Edwin J. Schulz was Senior Vice-President of Operations, Controller and Principal Accounting Officer; he owned 3,200 shares. Rubel L. Phillips was Southern Region Vice-President; he owned an option to purchase 40,000 shares.

Count One of the nine-count indictment charged that the appellants defrauded Homex shareholders, officers, directors, auditors and others in registration statements filed in 1970 and 1971 with the Securities Exchange Commission ("SEC") covering the public offer and sale of common and preferred Homex stock. The government charged that this was accomplished by inflating reported earnings and by falsifying and concealing adverse material information in violation of 15 U.S.C.

§ 77q(a)[1] and 15 U.S.C. § 77x.[2] Count Two charged that appellants wilfully and knowingly made and caused to be made untrue statements of material facts, and failed to disclose material facts necessary to correct the misleading statements, in the 1971 registration statement filed with the SEC covering the public offer and sale of Homex preferred stock, also in violation of 15 U.S.C. § 77x. Counts Three through Eight charged that appellants devised a scheme to defraud Homex securities purchasers and others, to obtain money and property by means of fraudulent representations, and to implement the scheme by using the United States Postal Service, all in violation of 18

[1] Section 77q(a), Title 15 U.S.C., provides as follows:

Fraudulent interstate transactions

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

[2] Section 77x, Title 15 U.S.C., provides as follows:

Penalties

Any person who willfully violates any of the provisions of this subchapter, or the rules and regulations promulgated by the Commission under authority thereof, or any person who willfully, in a registration statement filed under this subchapter, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $10,000 or imprisoned not more than five years, or both.

U.S.C. § 1341.[3] Specifically, appellants were charged with mailing on separate occasions two prospectuses, two annual reports and two quarterly reports to shareholders. Finally, Count Nine charged that appellants conspired to defraud the United States and the SEC and to violate 18 U.S.C. § 1001[4] and

[3] Section 1341, Title 18 U.S.C., provides as follows:

Frauds and swindles

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

[4] Section 1001, Title 18 U.S.C., provides as follows:

Statements or entries generally

Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry shall be fined not more than $10,000 or imprisoned not more than five years, or both.

15 U.S.C. § 78ff[5] as well as 18 U.S.C. § 1341 and 15 U.S.C. §§ 77q(a) and 77x, such conspiracy being in violation of 18 U.S.C. § 371.[6] The jury found each appellant guilty of each charged violation.[7]

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[5] Section 78ff, Title 15 U.S.C., provides as follows:

Penalties

(a) Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than five years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

[6] Section 371, Title 18 U.S.C., provides as follows:

Conspiracy to commit offense or to defraud United States

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, any one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

[7] Judge Frankel sentenced the appellants as follows:

David Stirling, Jr.—One year concurrent terms of imprisonment, one year of unsupervised probation, concurrent fines totaling $10,000, suspended sentence on the conspiracy charge.

William G. Stirling—Six month concurrent terms of imprisonment, one year of unsupervised probation, concurrent fines totaling $5,000, suspended sentence on the conspiracy charge.

Harold Yanowitch—One year concurrent terms of imprisonment, one year of supervised probation, concurrent fines totaling $2,000, suspended sentence on the conspiracy charge.

The story is a complicated one, involving land transactions that were not what they were claimed to be, labor relations that were not only inappropriately "cozy" but undisclosed, contracts for module sales based upon guile and trickery rather than agreement, and deceptive bookkeeping practices for which appellants have finally been held accountable. The record shows that appellants engaged collectively in a calculated and multifaceted plan to give the investing public the false impression that Homex was in a sound and steadily improving financial position and at the same time withhold adverse information that was material to an accurate appraisal of the company's prospects. The enterprise began in 1968; in 1970 and 1971 Homex stock was sold to the public for a total of $39 million; in 1972 the company was bankrupt. The jury could permissibly have the found the following.

I. THE FOUNDATIONS: INCORPORATION AND GOING PUBLIC

Homex was incorporated as a close corporation in Delaware in 1968; its principal offices and factory were located in Avon, New York, a suburb outside Rochester. The Stirling brothers were its founders, officers and principal owners. Shortly after incorporation, Homex made a private offering, selling 1.6 million shares at $1 each. It thus began as a relatively small concern, doing business primarily with private residential projects developed by the Stirlings. It soon became clear, however, that it would be in the best business interests of Homex to exploit the then-budding public housing market. Accordingly, Homex focused its efforts on sales to public housing authorities in federally-financed housing programs.

In late 1968, the Stirlings decided to explore the possibility of "going public" and approached R. W. Pressprich & Co. as a prospective underwriter. Pressprich agreed to underwrite the public sale of Homex common stock on the condition that Homex's annual net earnings totaled $1 million, as projected by the Stirlings. In January of 1969, when the agreement with

Pressprich was reached, Homex was reporting profits at the end of the second quarter of approximately $390,000 from the sale of modules and gross land sales totaling $4.7 million.

By April 30, 1969, however, the end of the third quarter, it became obvious that year-end profits would fall far short of the $1 million required for the underwriting, third quarter gross sales totaling only $900,000. At this point Homex arranged two "sales" of land holdings in order to boost total sales and profits to the amount required for the Pressprich underwriting.

The Kece Land Sale.

Peter Thun was the general partner of a limited partnership called Hollyrood Park Associates, located in Clay, New York; the Stirlings were limited partners. In May, 1969, David Stirling offered Thun two parcels of land owned by a Homex landholding subsidiary, Hollyrood Park II, Inc. Thun had a right of first refusal on both parcels. He indicated that he was interested in only one of the parcels—the one adjacent to his Hollyrood Park project—but only if it were part of an economically reasonable package consisting of both the purchase of the land for $325,000 and the development of Homex of a plan to build a 330-unit modular apartment building. In other words, he was interested in the land only if apartment units could profitably be built on it. Because Stirling was unable to quote a price for the development of such an apartment complex, Thun arranged to have the land purchased by Kece Associates, Ltd., a newly-formed shell corporation, in such a way as to maintain control over the land and at the same time incur minimal risk. Kece Associates made a 10 percent down payment, assumed existing mortgages on the property and gave a purchase-money mortgage that required interest payments and an annual principal reduction of $10,000 for the first five years.

In practical effect, as the government suggests, this $325,000 "sale" was a purchase by Thun of an "option" on the land. Indeed, Thun himself so characterized the practical effect of the arrangement. He stated that if it had been otherwise he

would not have considered entering into it at all. Under the agreement, if Thun were to decide that the construction of a 330-unit apartment project would not or could not be financially advantageous, he could merely order the termination of mortgage payments and, while relinquishing all rights to the land, shed all mortgage responsibilities. The mortgage itself included exculpatory language of the sort commonly expressed reluctance. Yanowitch, and eventually David Stirling, then assured them that, if anything went "awry," Homex would either repurchase the land or find another purchaser. In effect, the purchasers were assured that they would not lose money on their investment. This assurance was repeated prior to closing when complications developed regarding a zoning ordinance that prohibited the type of shopping center facilities the purchasers were interested in constructing. Yanowitch assured them that a variance would be obtained. Yanowitch also told them that they would be "getting some stock in Stirling when it went public." Homex declined to enter into a written indemnification agreement, but it is clear that Falcone, Barbato and Shapiro believed that, if they agreed to enter into the purchase agreement, Homex would protect them from losses.

The deal was closed on August 18, 1969, after the end of the fiscal year; the deeds were back-dated to June 30, 1969. Falcone, Barbato and Shapiro had created Reseac Realty, Inc. ("Reseac"), to purchase the land, which it did by transferring $80,000 as down payment, assuming $30,000 and $13,000 mortgages on the property and granting a $302,000 purchase-money mortgage. No principal payments were required for the first three years.

HKF Audits the 1968-1969 Fiscal Year.

On August 27, 1969, the accounting firm of Harris, Kerr, Foster & Company ("HKF") certified the Homex financial records for the 1968-1969 fiscal year. HKF certified for inclusion as income the $325,000 receivable from the Kece transaction and the $425,000 receivable from the Reseac

transaction. The inclusion of these two "sales" boosted Homex's net income after taxes slightly above the $1 million required for the Pressprich underwriting.

During the audit, Yanowitch told HKF that he had personal knowledge of Reseac's ability to honor its mortgage commitment and that, in the event of a default by either Kece or Reseac, the land could easily be sold to satisfy the mortgages. Yanowitch told HKF that the agreed-upon design and manufacture of modules for the Kece Property would be at published prices; he failed to tell HKF that the parties had not agreed upon the cost of installing the modules other than to say it would be reasonable. In other words, he did not tell HKF that the completion of the "sale" depended upon certain conditions being met by Homex in the future. Yanowitch also neglected to tell HKF of the assurances made to Reseac regarding the zoning restriction and of the commitment by Homex to repurchase the land or arrange for a purchaser if anything went wrong. Finally, although he told HKF that Homex and Reseac had no stockholders in common, he did not tell HKF that promises had been made to Falcone, Barbato and Shapiro that arrangements would be made for them to purchase Homex stock at the anticipated public offering for the issue price.

The 1970 Registration Statement.

On October 1, 1969, Homex filed a registration statement with the SEC in connection with the issuance of Homex common stock. It made scant mention of the Kece and Reseac land transactions:

> Two sales of undeveloped land acquired at the time of organization of the Company accounted for approximately 18% of the Company's net income during its first fiscal year. The larger parcel was purchased by a developer who subsequently entered into an agreement with the company to purchase modular housing for installation on such land.

The registration statement became effective on February 19, 1970, for a total sale of 1,175,000 shares of Homex common stock at $16.50 per share, netting Homex approximately $20 million.

II. THE SCHEME AS ASSEMBLED: STAYING "PUBLIC".

HKF Audits the 1969-1970 Fiscal Year.

During August and September, 1970, HKF again met with Homex, this time to certify the financial records of Homex for the 1969-1970 fiscal year. In connection with this audit, Paul Kuveke, then Executive Vice-President and Treasurer of Homex, wrote a letter to HKF stating that, although both the Kece and Reseac mortgages were in default in the amount of $559,624 as of the end of the fiscal year, Homex nevertheless considered them "collectible" and properly recognizable as income for auditing purposes. He cited as reasons for this belief the receipt from Kece on September 27, 1970, of a payment that brought its obligations up to date; the expectation that a Reseac payment would also be received, given what appeared to be favorable business conditions for Reseac; and a recent appraisal of the parcels that placed the fair market value of the Kece land at $310,000 and the Reseac land at $403,650.

The Kece Mortgage Payment

The Kuveke letter failed to disclose to HKF the rather complicated set of transactions that "facilitated" the September 27, 1970, Kece mortgage payment. Thun and the Stirlings were involved in a number of enterprises besides Hollyrood Park Associates. Among these were Fairway Associates, the owner of an apartment development in Rochester, New York; Mobile Townes Corporation, the owner of a mobile home park in Syracuse, New York; and Pennscott Properties, a management company for Mobile Townes.

In September, 1970, a dispute arose regarding claims by Homex that Thun and his various enterprises owed approxi-

mately $90,000 to Homex and its subsidiaries. From the record, it appears that this $90,000 consisted of approximately $34,000 due Homex for the construction of a clubhouse on Hollyrood Park property, approximately $35,000 on a demand note held by Homex and, apparently, approximately $23,000 due on September 2, 1970, as mortgage payment on the Kece-Riverbend parcel. It was Thun's opinion that the best way to clear up the confusion was for his enterprises to buy out the Stirlings' interests in Mobile Townes and Pennscott, thereby simplifying the ownership of the various corporations and at the same time providing payment to the Stirlings.

Jack Doerge, a director of Mobile Townes, indicated to Thun that he was interested in acquiring additional Mobile Townes stock and would transfer $90,000 for that purpose. $90,000 was delivered to Al Bartz of Homex in exchange for Pennscott and Mobile Townes shares held by the Stirlings. The Mobile Townes stock was not, however, delivered that day. Instead, it was placed in escrow until Thun confirmed to HKF the authenticity of the purchase-money mortgage on the Kece-Riverbend property. On October 5, 1970, Thun confirmed to HKF that the mortgage was authentic. In effect, then, the same $90,000 that was used to purchase the Stirlings' stock in Pennscott and Mobile Townes was used to satisfy the disputed $90,000 indebtedness. At the same time, and in the same transaction, ownership of valuable stock was transferred, $90,000 worth of debts was forgiven, and Homex could present to its auditors a confirmed and therefore arguable collectible mortgage to support its recognition as income.[8]

[8] This same pattern of behavior recurred in the spring of 1971, this time in response to an audit being done by Peat, Marwick, Mitchell & Co., Homex's new auditors. The Stirling brothers cancelled all of their interests in Hollyrood Park Associates. Peter Thun then paid two notes held by the Stirlings totaling approximately $35,000 as well as $22,000 on the Kece mortgage and, on March 16, 1971, signed a confirmation of the Kece mortgage to be forwarded to PMM.

Reseac Developments

The Kuveke letter to HKF also failed to reveal significant background information regarding the Reseac land transaction. On July 16, 1970, Gerald Beckerman, the attorney for Falcone, Barbato and Shapiro, met with Carl Wren, Homex's Director of Market Research, and Ruben Davis, assistant to Yanowitch, in an effort to resolve problems that had developed regarding the property sold to Reseac. The problems were considerable: contrary to Homex's assurances, the zoning restriction had not been lifted; Falcone, Barbato and Shapiro had become "quite disillusioned" with the property and were no longer inclined to develop or retain it; Reseac had no cash and could not make the interest payment due on July 1, 1970; and, finally, Reseac could not pay the real estate taxes or the obligations on the assumed mortgages. In short, Falcone, Barbato and Shapiro wanted Homex to make good on its promises either to repurchase the land or arrange for another purchaser.

Wren and Davis made it clear to Beckerman that, although the land was considered to be a good financial value, Homex would not repurchase it. They did, however, offer to assist in the sale or development of the property. Beckerman indicated that Falcone, Barbato and Shapiro would be willing to continue in the arrangement as long as there was waiver by Homex of the mortgage payments, a condition that Homex found unacceptable. The meeting was amicable, but it clearly met neither the hopes nor the expectations of the Reseac principals. Kuveke's letter mentioned none of this.[9]

[9] Ultimately, the Reseac principals sold the land to Yanowitch's former law partners, John Garrity and Bernard Frank. The government charged that Yanowitch coaxed Garrity and Frank into purchasing the Reseac land by assuring them that Homex would send them more legal work. Their legal fees from Homex did in fact increase substantially.

Accounting Practices

The HKF audit of Homex's 1969-1970 financial condition prompted Homex again to shade the truth, this time in connection with the accounting methods utilized by the corporation. Typically, a Homex contract would state one price for the design and manufacture of modules and another price for their installation. At one time, Homex used sale contracts that transferred title and risk of loss to the buyer upon delivery of the finished apartment module to an independent carrier. When this contract was used, Homex recorded income from the sale of the module as of the moment the module was delivered to the carrier. During the 1969-1970 fiscal year, however, Homex changed to a "turn key" contract under which Homex retained title and risk of loss until installation was complete and a closing had occurred. Thus, the sale was not complete until after the closing, when the new owner could actually claim possession and "turn the key." For obvious reasons, waiting to recognize income until the day that the key was turned troubled Homex officials. Homex, through Schulz, wanted HKF to certify as income the value of sales contracts for modules that, although not yet delivered or installed, had been "manufactured and assigned to specific contracts." This method of calculation allowed Homex to recognize the manufacture price of a module as income long before it actually received any cash for that module.

During the 1969-1970 fiscal year, Homex also changed the provisions of its contracts dealing with installation. Where once Homex had not recorded any portion of the installation price as income until the installation was complete, Homex now wanted HKF to recognize as income that proportion of the installation price equal to the proportion of the installation completed. This system of recognition is called the "percentage of completion" method.

To support these methods of recognizing income, Schulz contacted and eventually retained Dr. Joseph A. Mauriello, an accounting professor at the New York University Graduate

School of Business Administration. As a result of the conversations with Schulz, Dr. Mauriello submitted to HKF an opinion supporting Homex's income recognition system, and HKF approved of its use. What Schulz did not reveal to Dr. Mauriello, or to HKF however, was the so-called "Christman Incident." Earlier in 1970, David Christman, an assistant controller in Homex's installation division, had discovered that profits for the installation phase of Homex operations were going to be one-half million dollars less than what they had been projected to be. Schulz instructed Christman to "delay recordation of the accounting entry embodying that calculation" until after the close of the fiscal year. This delay prevented the reduction of the installment division's 1969-1970 profits by 60 percent and the reduction of Homex profits for that period by 11 percent. According to Dr. Mauriello, had the delay been disclosed to him, it would have altered his opinion regarding the propriety of the income reporting methods of the installation division.

The Route 57-31 Land Sale.

In December, 1970, Harold L. Wynn, Jr., and William Grago, Jr., partners in the Empire Pipeline Corporation, and their attorney, Carmen Grasso, met with David Stirling to discuss the purchase of 138 acres of land at the intersection of routes 57 and 31 in Clay, New York. The land was owned by Homex's land-holding subsidiary, Kabeth Properties, Inc. The purchase price of the land was $2.1 million. A 30-acre portion of the land was then the subject of a state condemnation proceeding, for which an award of $1 million was anticipated.

Wynn told Stirling that, although the purchase price seemed fair, the three of them could not afford to make the investment. Stirling suggested that the condemnation award could go toward the purchase price and that he would accept a 10 percent down payment of $210,000 and a purchase-money mortgage with no principal or interest due for five years. Wynn responded that they could not even afford the down payment.

Stirling then proposed that Homex arrange financing in such a way as to enable them to "purchase" the land without transferring any money whatsoever to Homex, and went so far as to assure sufficient business activity to enable payment of obligations that did arise. Although Stirling declined to give a requested corporate guarantee against any investment losses, he did give his personal guarantee to that effect. The parties agreed.

In order to facilitate the "sale" without the transfer of funds, Stirling and Yanowitch instructed Charles Marshall, former banker and then Homex employee, to arrange a bank loan to Route 57-31 Development Corporation ("Route 57-31"), a shell corporation set up by Wynn and Grago to take title to the property. He was instructed to negotiate the loan with the First National Bank of Rochester, New York, and to assign the condemnation award due Homex as collateral. First National then loaned $250,000 to Route 57-31, requiring the personal guarantees of Wynn and Grago on the note. This was in turn paid over to Kabeth Properties. No closing occurred and no deed was transferred.

On January 6, 1971, Yanowitch, Schulz and Ruben Davis, then Assistant Vice President and Associate General Counsel of Homex, met with Dr. Mauriello to discuss recognizing as income the $1.4 million profit on the "sale" of land to Route 57-31 for $2.1 million. The purpose of the meeting was to secure Dr. Mauriello's favorable opinion for use during the audit of the 1970-1971 fiscal year. In particular they discussed SEC Accounting Series Release No. 95, which commented on the propriety of real estate transaction accounting methods that recognized as income any profits not received at the time the

transaction was recorded.[10] Dr. Mauriello eventually advised HFK that the sale of land by Homex to Route 57-31 was a

[10] The SEC statement noted that:

> The recognition of profit at the time of sale in accordance with generally accepted accounting principles is appropriate if it is reasonable to conclude in the light of all the circumstances that a profit has been realized. Profit is deemed to be realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sales price is not reasonably assured. Thus recognition of profit is appropriate only when a bona fide sales transaction has taken place, and then only to the extent that the consideration received in the transaction can be reasonably evaluated. In some of the situations coming before us it appears from the attendant circumstances that the sale of property is a mere fiction designed to create the illusion of profits of value as a basis for the sale of securities. Moreover, even in bona fide transactions the degree of uncertainty as to ultimate realization of profit may be so great that business prudence as well as generally accepted accounting principles would preclude the recognition of gain at the time of sale.
>
> Circumstances such as the following tend to raise a question as to the property of current recognition of profit:
>
> 1. Evidence of financial weakness of the purchaser.
> 2. Substantial uncertainty as to the amount of cost and expenses to be incurred.
> 3. Substantial uncertainty as to amount of proceeds to be realized because form of consideration or method of settlement, e.g., nonrecourse notes, noninterest-bearing notes, purchase of stock and notes with optional settlement provisions all have indeterminable value.
> 4. Retention of effective control of the property by the seller.
> 5. Limitations and restrictions on the purchaser's profits and on the development or disposition of the property.
> 6. Simultaneous sale and repurchase by the same or affiliated interests.
> 7. Concurrent loans to purchasers.
> 8. Small or no down payment.
> 9. Simultaneous sale and leaseback of property.

bona fide sale for which income could and should be recognized as of the date of the sale. Neither the true scope of the agreement between Homex and Route 57-31 nor the nature of the background financial arrangements supporting the agreement were disclosed to Dr. Mauriello. Nor were the Homex auditors, HFK, and its eventual successor, Peat, Marwick, Mitchell & Co. ("Peat Marwick"), told of those details.

In fact, David Stirling, Yanowitch and Schulz tailored the Route 57-31 "sales contract" so as to avoid possible auditor objections, and ultimately represented that there were no undisclosed "assets pledged or assigned as security for liabilities" and "[t]hat the officers and directors of [Homex] had no direct or indirect relationship with Route 57 and 61 [sic] Development Corporation."

The Greater Gulf Coast Housing Development Corporation.

In late 1970, appellant Rubel Phillips, a Mississippi attorney, helped organize on Homex's behalf a group of Mississippi citizens into a non-profit public benefit corporation that would be eligible for federal, state and local financing of housing projects. The corporation was called the Greater Gulf Coast Housing Development Corporation ("Greater Gulf"). In December, 1970, Greater Gulf and Homex entered into two agreements. The first, for $100 million, called for the construction of a 5,000-unit housing project over a 6-year period, and was conditioned upon the modules being constructed in a Mississippi factory. The second, for $15 million, called for the construction of an 800-unit modular housing project over an 18-month period. These agreements, however, were effectively worthless unless and until Greater Gulf was successful in obtaining a funding commitment from appropriate government agencies.

Originally, the Greater Gulf projects were to be funded by the United States Department of Housing and Urban Development. By January, 1971, however, this plan was changed and funding was sought from the Farmers' Home Administration of the United States Department of Agriculture ("FHA"). During February, Phillips arranged for two FHA officials, S.B. Wise and W.T. Richardson, to visit Avon, New York, and to discuss with Yanowitch and David Stirling the commitment of FHA funds to Greater Gulf for the purchase of Homex modules. Wise and Richardson, however, were unable to authorize the funding commitment, a matter of some concern to Homex officials in that Homex had already chosen Merrill, Lynch, Pierce, Fenner & Smith ("Merrill Lynch") to underwrite a July, 1971, issuance of Homex stock. This issuance required the filing of a second registration statement with the SEC, which in turn required a certificate by Homex auditors of the financial records for the fiscal year up to January 31, 1971. About that time, Homex discharged HFK and retained Peat Marwick as auditors.

On February 24, 1971, Phillips secured the signature of Greater Gulf's volunteer President Kenneth Caron on a series of documents, including a sales contract between Homex and Greater Gulf which was backdated to December 28, 1970. Phillips explained to Caron that the back-dating was merely for funding purposes. Phillips also told Caron that the contract was the same as an earlier $100 million agreement that Caron actually had signed in December, 1970, except that it provided for fewer units. Phillips did not call to Caron's attention the absence of the contract clause requiring the modules to be manufactured in Mississippi. Phillips also gave Caron a letter from Greater Gulf to the FHA requesting a $15 million loan and a response from the FHA, purportedly signed by Richardson, committing the FHA to the loan. Caron signed the FHA response in order to accept the loan. Richardson's signature on the FHA commitment was in fact forged at Phillips' instruction by his secretary. On the next day, February 25, 1971, Schulz instructed the Homex accounting department to credit Homex with the sale to Greater Gulf of 566 modules for $6,786,900. Later in the year, still without a valid contract or a genuine government funding commitment, Homex assigned another 60

modules to the Greater Gulf project in order to boost reported year-end revenues.

The forged commitment letter was kept by Yanowitch and used to the benefit of Homex on three important occasions. First, it was used to "assist" Dr. Mauriello in arriving at an opinion regarding the propriety of recognizing income from the Greater Gulf transaction. Second, it was shown to Homex's commercial bankers. Third, it was shown to Peat Marwick on March 19, 1971, to "aid" them in their audit of the financial records for purpose of the approaching issuance. The Greater Gulf sale was described to Peat Marwick verbally and supported by the backdated December 28, 1970, contract. It was also supported by a contract between Greater Gulf and the U.S. Shelter Corporation ("U.S. Shelter"), a wholly-owned financing subsidiary of Homex, in which Greater Gulf agreed to pay a finder's fee of $300,000 to U.S. Shelter for securing the $15 million federal funding commitment.

Accounting Practices During the 1970-1971 Fiscal Year.

Three incidents during the 1970-1971 fiscal year make it clear that Homex accounting practices during that time were considerably less than straightforward. First, a significant proportion of the modular sales recorded for the first quarter was based upon the assignment of modules to purported sales with housing authorities in Clay, New York, and Southbridge, Massachusetts. These sales were reported as income notwithstanding the fact that there existed neither written contracts nor funding comminmtnts to support the assignments. The unaudited first quarter earnings were supplied to various commercial and investment bankers, eventually leading to an offer to purchase Homex debentures.

Second, beginning in December, 1970, Homex maintained not only a computer file showing assignment of particular modules to construction projects, but also a "special" or "simulation" file. Formally, these files were known respectively as File I and File II: computer room employees, however,

called the first file the "real world" file and the second file the "Mickey Mouse" file. Mr. Wilbur Rumley, Scheduling Coordinator for Homex Operations Control, testified at trial that "on File I some apartments were assigned to one project and on File II they were assigned to another." In other words,the Mickey Mouse file was used by Homex to verify to its auditors that ccertain modules were assigned to certain contracts thus justifying the inclusion of the price of those modules as income.

Finally, just prior to the filing to Homex's 1971 registration statement, an ambiguous debt confirmation gave Peat Marwick reason to question the inclusion by Homex of $832,000 as an account receivable. Homex had reported the figure as income notwithstanding the fact that it had been spent on the so-called "soft costs" of constructing the Mississippi plant, costs such as architectural and engineering fees and site selection costs. Such costs may be capitalized as costs of construction. Apparently on the theory that Mississippi authorities would one day reimburse it for the expenditures, Homex reported them under accounts receivable. As a result of Peat Marwick's inquiries, Homex shifted the $832,000 from accounts receivable to costs of construction in process.

The 1971 Registration Statement.

On April 21, 1971, Homex filed with the SEC a registration statement intended to cover the sale of 1,025,000 shares of Homex common stock. This was changed by amendment on May 28, 1971, to a new issue of 500,000 shares of Homex cumulative convertible preferred. On July 29, 1971, Merrill Lynch sold and distributed 500,000 shares of Homex preferred stock at $40 per share, netting Homex $19 million.

Labor Relations

In draft, the section of the 1971 registration statement dealing with the labor relations enjoyed by Homex summarized its various labor agreements and noted that:

> The Company believes that the above-mentioned agreements have contributed to its present satisfactory labor

relations, but it can give no assurances that it will be free of labor problems in the future.

The final registration statement, however, contined no caveat regarding future labor relations. Nor did it reveal the intricate investment relationships that had developed between Homex and labor and which no doubt contributed to the "satisfactory labor relations."

In June, 1969, Homex entered into a labor agreement with the United Brotherhood of Carpenters and Joiners of America ("UBCJA"), the exclusive bargaining agent for Homex production employees. This in itself was a matter of some moment, for organized labor had expressed concern about the possibility that Homex-type production techniques would eliminate jobs in the housing and construction industries. Thus, Homex press releases described it relationship with the UBCJA as "precedent-setting." The government, however, claimed that the relationship was more accurately characterized as "cozy."

For example UBCJA members and officials had, in November of 1968, helped convince the Akron, Ohio, Planning Commission Appeals Board, a municipal zoning authority, and the Akron City Council, prospective Homex customers, that the Homex concept of housing construction was not opposed by organized labor. The coziness of the Homex UBCJA relationship went considerably further than mere collaboration, however. The record shows that the 1971 registration statement and other reports were materially false and misleading in that they failed to disclose that Homex officials had arranged for the sale of approximately $240,000 worth of Homex common stock to seven officials and members of the UBCJA at approximately $80,000 less than the stock's market value. In addition, when the market value fell, Homex arranged for the purchase from those same union officials and members of approximately $64,000 worth of Homex common stock at approximately $136,000 above the fair market value.

On October 1, 1969, Homex filed its registration statement in connection with the issuance of the 1,175,000 common

shares. The prospectus made the following observation on Homex's labor relations:

> [T]he modules are manufactured and dwellings are erected completely by building trades union labor. The Company has had no strikes or interference with its production of on-site erection of its dwelling units.
>
> Freedom from work interruptions as a result of labor problems is important to the continued success of the Company's business. Although the Company believes the above-mentioned agreements should contribute to the continuation of its present satisfactory labor relations, it can give no assurance that the Company and its subsidiaries will be free of labor problems in the future.

During the following months, conversations regarding the possible purchase by various UBCJA officials and members of soon-to-be publicly offered Homex stock were pursued. On January 6, 1970, Yanowitch asked the Homex legal department to consider the legality[11] of designating union officials as eligible to purchase Homex stock at the $16.50 issue price.[12] The department did not find such designation unlawful, but it did advise that the arrangement would, if made public, be bad for Homex's image. Despite this advice, and in anticipation of the February 19, 1970, offering, Homex submitted to Pressprich a list of several hundred names as "issuer-designated sub-

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[11] Section 180.15 of the New York Penal Law reads as follows:

> A person is guilty of bribing a labor official when, with intent to influence a labor official in respect to any of his acts, decisions or duties as such labor official, he confers, or offers or agrees to confer, any benefit upon him.

[12] According to the prospectus in use throughout the 90 day delivery period for initial registrations, Pressprich had agreed to Homex's designating 117,500 shares for sale to certain persons "promptly upon the commencement of this offering and any shares not so purchased will be reoffered to the public at the public offering price."

scribers," including the names of seven UBCJA officials. Kenneth Langone, President of Pressprich, questioned the propriety of designating labor union representatives as subscribers, arguing that they were people with whom Homex was supposed to have an arm's length relationship. As a result, the names were taken off the list.

On February 19, 1970, the Homex registration became effective, and 1,175,000 shares were sold at $16.50. Within minutes, Homex shares were being traded at $34 per share; one month later the price was up to $52 a share. David Stirling then contacted Langone and argued that the union officials should have received the stock as had been discussed. Langone, having overcome his earlier reservations, proposed backdating sales to the union representatives to the $34 per share aftermarket purchase price. Stirling agreed to this arrangement and instructed Charles Marshall, then his banker at the Central Trust Company in Rochester, to loan the purchase price of the stock to the union officials. Stirling guaranteed repayment of the loan under his personal line of credit, though at trial he claimed the guarantee was a forgery. In sum, on March 20, 1970, seven UBCJA officials "purchased," effective February 19, 1970, and aided by a loan arranged and guaranteed by Stirling, approximately $240,000 worth of Homex stock for approximately $160,000.

On January 8, 1971, Homex's annual report and proxy statement were mailed. The annual report contained the following comment on Homex labor relations:

> Stirling Homex is pleased to have been the first modular housing manufacturer to sign a national labor contract with the United Brotherhood of Carpenters and Joiners of America (AFL-CIO) for both in plant production and on-site installation.

A few days earlier, Homex's chauffeur, William McCann, acting on Yanowitch's instructions, cashed six Homex checks for $11,500. These checks were payable to cash, and had been

issued on the basis of false travel and entertainment expense vouchers. The money was used to pay the interest due on the Central Trust Company loan to the union officials. There was no mention of this in the annual report or proxy statement.

Finally, in November, 1971, Homex went even further to foster its "precedent-setting" labor relations. By then, Homex stock had begun to fluctuate between $15.00 and $18.00 per share. William and David Stirling, along with Yanowitch, arranged for the repurchase of the union officials' stock at $34.00 per share, the amount for which the stock had been originally "purchased." We note that the labor contract with Homex expired at the end of September, 1971, and a new three year contract was successfully negotiated.

Kece, Reseac and Route 57-31 Revisited

The original 1971 registration statement included the following representation regarding the Kece, Reseac and Route 57-31 land transactions:

> During the fiscal year ended July 31, 1969, the Company sold two parcels of undeveloped land [Kece and Reseac] and during the seven months ended February 28, 1971 it sold one parcel [Route 57-31]. Trade sales included $750,000 for the year ended July 31, 1969, and $1,822,723 for the seven months ended February 28, 1971 in respect of these sales, which resulted in net income for the respective periods of about $187,000 (18% of the total net income) and $556,000 (35% of the total net income). All the sales of undeveloped land provided for deferred payment of part of the purchase price.

In addition, under "Notes to Consolidated Financial Statements," the registration statement described in some detail the Kece, Reseac and Route 57-31 arrangements as "Long-Term Receivables."

The descriptions in the Notes had been brought about by pressure on Homex from HKF to disclose the nature of the

transactions more accurately. In turn, these descriptions prompted the SEC to inquire into the arrangement and, eventually, to require an even more detailed disclosure regarding the Route 57-31 arrangement. Despite various intentional misrepresentations by Homex, the SEC ultimately prohibited inclusion of the $2,100,000 Route 57-31 "sale" as income. The registration statement as finally amended and filed left the Kece and Reseac representations the same, but reported the Route 57-31 transactions under "Inventories" as follows:

> The Company has entered into a contract to sell a parcel of land with costs of $673,017 for a price of $2,100,000. The Company has received a down payment of $210,000 which has been accounted for as an option deposit.

Thus, Homex was finally forced to acknowledge that land transactions of the sort it was engaged in were not honestly characterizable as sales and income but rather as contracts for possible subsequent sale—in other words, option contracts.

Accounting Practices Revisited

Both the draft and final 1971 registration statements represented that Homex recognized the sale of modules "when the units are manufactured and assigned to specific contracts." This prompted the SEC to inquire whether income was being recognized "too far in advance of the date of billing to customers." Homex, through Schulz, responded by letter with the following information:

> When the following conditions have been met, the Company records as sales and charges costs with the related costs of modules manufactured.
>
> 1. The Company must be designated by the local housing authority, non-profit sponsor or other agencies as the contractor for the project. This designation is supported by a formal commitment from the customer to the Company.

> 2. The customer must have obtained and submitted evidence to the Company that a commitment of monies to fund the project has been obtained from the appropriate governmental agency under which the project has sponsorship.
>
> 3. The numbers and types of modules and the general site plan and improvements must be identified and be the subject of the agreement between the Company and its customers.
>
> 4. The Company must assign the manufactured module to a specific project and physically identify the module as being assigned to and reserved exclusively for that specific project and customer. (At the present time this identification is physically attached at the earliest stage of the manufacture of the module.)
>
> 5. The module must completed and be ready for shipment to the customer.
>
> *When all these events have occurred, and only when all these events have occurred, does the Company recognize income.*

(emphasis added).

Clearly, "all these events" had not "occurred" with regard to the Southbridge, Massachusetts, and Clay, New York, projects. Similarly, they had not occurred with regard to the Mississippi project. The Mickey Mouse file hardly substantiates Homex's claim that it relied solely upon the existence of these events for income reporting. In fact, large scale reassignment of modules to various contracts seems to have taken place whenever it met Homex's needs. Had this practice been disclosed, it would have been clear to Peat Marwick that, as one of its auditors testified at trial,

> Homex was not producing to a specific customer order and exclusively reserving modules for contracts, but rather

manufacturing for inventory and therefore instead of having those units in sales, those units would have been in inventory, which would have had a significant effect on the income recognition and the portrayal of the balance sheet.

The 1971 Annual Report.

On October 8, 1971, Homex mailed its Annual Report to stockholders. As might be expected, it mentioned very little of the story just told.

III. BANKRUPTCY: THE SCHEME COLLAPSES.

On July 12, 1972, the house of cards collapsed. Less than one year after the sale of Homex preferred stock to the investing public, and approximately two years after the sale of Homex common stock, sales that totaled $39 million, Homex filed a petition for reorganization under Chapter X of the Bankruptcy Act. This was immediately preceded by the posting of large losses for the early parts of the 1971-1972 fiscal year and the resignations of David and William Stirling, Yanowitch, Schulz and Phillips.

IV. APPELLANTS' LEGAL CLAIMS.

We now turn to the various legal arguments advanced by the individual appellants.

The Scope of the Indictment and the Sufficiency of the Evidence.

David Stirling, Yanowitch and Schulz argue that the district court committed reversible error by refusing to withdraw from the jury's consideration various specific allegations in the indictment as to which, they claim, there was insufficient evidence.[13] They rely on this Court's decision in *United States v.*

[13] William Stirling made no request of the district court to strike or narrow the indictment. We consider, *infra*, his argument regarding the denial of his Rule 29 motion for acquittal.

Natelli, 527 F.2d 311 (2d Cir. 1975), *cert. denied*, 425 U.S. 934 (1976). Their argument is that the failure to withdraw the allegedly unsupported allegations rendered the jury verdict fatally ambiguous. We disagree. Their argument depends upon an incorrect understanding of the law and their claims of insufficient evidence are not well taken.

In *United States v. Natelli, supra*, this Court considered an appeal by certified public accountants from convictions for making materially false representations in proxy statements filed with the SEC. They had been convicted under a one-count indictment that alleged two separate and distinct criminal episodes. A single, unifying scheme to defraud was not alleged; nor was there an allegation of a conspiracy. The district court had instructed the jury that a finding of guilt under either specification was sufficient to support a conviction; the jury found both defendants guilty. With regard to one of the defendants, however, the Court of Appeals held that there was sufficient evidence for conviction based on only one of the specifications. The Court explained:

> A difficulty does arise . . . if it is found as a matter of law that there should have been a directed verdict for a defendant on one of the specifications for insufficiency of evidence. The verdict then becomes ambiguous, for the jury could have rejected the specification which the appellate court holds sufficiently proved, and have convicted only on the specification held to be insufficiently proved. In that event, there seems to be no alternative to remand for a new trial. That is the general principle.

527 F.2d at 25. The Court noted further that "[w]hen there is more than one specification as a predicate for guilt, each dependent on particular evidence which is unrelated to the other, it would be sound practice to instruct the jury that they must be unanimous on a particular specification to convict." *Id.*

In contrast, this case presents a different situation, one more closely akin to that considered in this court's decision of

United States v. *Amrep Corp.*, 560 F.2d 539 (2d Cir.), *cert denied*, 46 U.S.L.W. 3436 (U.S. Jan. 10, 1978). There the Court reviewed a conviction of twenty counts of mail fraud and five counts of interstate land sale fraud. The *Amrep* appellants argued, as appellants do here, that, in proving a scheme to defraud by several misrepresentations, the government must prove every misrepresentation charged in the indictment. They argued further that the government's failure to meet this burden required a retrial. In rejecting this argument, the Court made the following observation:

> "[Appellants] confuse the scheme to defraud, which is the gist of the offense, with the means adopted to effectuate the scheme." A scheme to defraud may consist of numerous elements, no particular one of which need be proved if there is sufficient overall proof that the scheme exists. Appellants' reliance on *United States* v. *Natelli* is misplaced. In that case, the defendant was charged in a single count with violating the securities laws by making false statements in a proxy statement. Because the crime charged consisted of the making of such statements, the erroneous failure of the trial court to direct a verdict as to one of the alleged falsities, arising out of a separate state of facts, made the jury's verdict ambiguous and required a new trial. *Here, the crime charged was the scheme to defraud, and the alleged false statements were merely means for carrying it into effect.*

560 F.2d at 546-47 (citations omitted; emphasis added). This is precisely the situation here. In addition, the Homex indictment charged a conspiracy which, under *Pinkerton* v. *United States*, 328 U.S. 640 (1946), makes each conspirator substantively liable for the foreseeable acts of his co-conspirators committed in the furtherance of the conspiracy. Finally, even if this were a *Natelli* rather than *Amrep* type case, the jury instruction given by the district court was precisely the type of instruction suggested by the *Natelli* Court.

The real question, then, is not so much whether there was sufficient evidence regarding each and every specification but, rather, whether there was sufficient overall proof of the alleged scheme to defraud and conspiracy. Viewing the evidence in the light most favorable to the government, *United States* v. *Glasser*, 315 U.S. 60, 80 (1942), and "'giving full play to the right of the jury to determine credibility, weigh the evidence, and draw justifiable inferences of fact,'" *United States* v. *Taylor*, 462 F.2d 240, 243 (2d Cir. 1972), *quoting*, *Curley* v. *United States*, 160, F.2d 229, 232 (D.C. Cir.), *cert. denied*, 331 U.S. 837 (1947), we have no doubt that there was sufficient evidence to convict the appellants of the substantive crimes. In addition, with regard to the sufficiency of evidence for the conspiracy convictions, our deliberations are governed by the following principles.

> "[T]he gist of the offense [of conspiracy] remains the agreement, and it is therefore essential to determine what kind of agreement or understanding existed as to each defendant." In making this determination, courts often look to knowledge and dependency as evidence of an agreement. These factors, in turn, may be inferred from an assessment of the nature of the criminal enterprise and the defendants role in it .... For such an inference to be drawn, however, it is necessary to examine "the qualitative nature of the act or acts [of each defendant] . . . in the context of the entire conspiracy ...."

United States v. *Taylor*, 562 F.2d 1345, 1352 (2d Cir.), *cert. denied*, 97 S.Ct. 2958 (1977) (citations omitted).

As the recitation of the facts above makes clear, there is no doubt regarding the existence of the alleged conspiracy. Each appellant played a central role in some if not all of the various elements of the common scheme and in the overall maintenance of its life. The purpose of the scheme was apparent; the responsiblity for the scheme is also apparent. Collectively, the

appellants did their best to take advantage of the plan and to keep it alive. Quite properly, they now share the consequences.

David Stirling was a central and motivating force in the Homex frauds and conspiracy. Apart from his involvement in and supervision of virtually every aspect of Homex operations, he was shown to be directly and significantly involved in the various land transactions and in the various representations regarding recognition of income. He was the key figure in the Reseac affair; he helped conceive the idea, he participated in making the side promises, he observed the deterioration of the transaction, and he did all he could to keep it alive so that Homex could continue to recognize income from it. He did this with full awareness of SEC standards regarding the reporting of income from land transactions. *See* note 10 *supra*. In addition, he told the SEC, the Homex auditors and the investing public that income was recognized only when specific modules were assigned to specific contracts, knowing full well the reassignment practices and policies of the accounting division. Finally, he knew about and participated in the adjustment of Homex accounts by delaying the entry of cost overruns in the installation department, reporting as income the Greater Gulf U.S. Shelter transaction, and attempting to capitalize the $832,000. This is by no means an exhaustive description of what David Stirling could permissibly be found to have done during his association with Homex, but it certainly constitutes convincing evidence of his guilt.

The same can properly be said about Harold Yanowitch. Quite apart from his constant presence and supervision, he was shown to have been directly involved in the Kece affair. He shielded from the auditors and Dr. Mauriello the true nature of the Kece and Route 57-31 transactions, even with full knowledge of the applicable SEC standards. The jury was instructed and could have found that, where Yanowitch did not know of the specific wrongdoings, he must have "deliberately closed his eyes to what otherwise would have been obvious to him and with a conscious purpose to avoid learning the truth." Although

appellant Schulz was primarily responsible for implementation of the accounting policies of Homex, Yanowitch quite clearly collaborated in the creation and furtherance of those deceptions.

Finally, Schulz's participation in the fraudulent accounting practices at Homex is clear. Although he may not have participated in the negotiation of the various land transactions, he was instrumental in the design and implementation of the accounting systems that made the extravagant claims of Homex income possible. His frequent discussions with Dr. Mauriello, the Homex auditors and the SEC, and the misrepresentations he made to them, were essential to the maintenance of the Homex fraud.

Paragraph 16.

The Stirlings and Yanowitch argue that the district court committed reversible error by denying their pre-trial motions to strike paragraph 16 of the indictment.[14] That paragraph is based on the appellants' failure to disclose in the second registration statement the true nature of Homex's relationship with union officials. They advance three separate bases in

[14] Indictment ¶16 reads as follows:

> 16. It was further a part of said scheme to defraud that on or about July 29, 1971, defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, and HAROLD M. YANOWITCH prepared and filed with the SEC registration statements and other reports which described Homex's several relations with the United Brotherhood of Carpenters and Joiners of America and its locals. Those statements were materially false and misleading, because as the defendants well knew, but failed to disclose, seven members and officials of the United Brotherhood of Carpenters and Joiners of America had had approximately $240,000 worth of Homex common stock purchased for them at approximately $76,800 less than the fair market value, and afterwards, when the fair market price had fallen, approximately $64,000 worth of Homex common stock sold for them at approximately $136,000 above the market price.

support of their argument: the privilege against self-incrimination; the double jeopardy clause; and the prejudice resulting from the allegedly inflammatory nature of the paragraph itself.

Self-Incrimination.

The self-incrimination claim is essentially this: if appellants had disclosed to the SEC and the public the true nature of the stock transactions with the UBCJA officials, they would have been admitting facts sufficient to form the basis for a criminal prosecution under the Taft-Hartley Act, 29 U.S.C. §186. Because of this, the argument goes, the Fifth Amendment must operate to protect them from prosecution for failing to make the disclosure in the first place. Appellants rely on *Marchetti* v. *United States,* 390 U.S. 39 (1968), and *Grosso* v. *United States,* 390 U.S. 62 (1968). Their argument, if accepted, would lead to the conclusion that securities misrepresentations would be constitutionally protected if the true but undisclosed facts would lead to criminal prosecution.

In *California* v. *Byers,* 402 U.S. 424 (1971), the Supreme Court noted that when "confronted with the question of a compelled disclosure that has an incriminating potential, the judicial scrutiny is invariably a close one." 402 U.S. at 427. It noted further that:

> Tension between the State's demand for disclosures and the protection of the right against self-incrimination is likely to give rise to serious questions. Inevitably these must be resolved in terms of balancing the public need on the one hand, and the individual claim to constitutional protections on the other; neither interest can be treated lightly.

Id. The Court upheld as constitutional a California "hit and run" statute that required the driver of a motor vehicle in an accident to stop at the scene and give his or her name and address. The Court held that compliance with an essentially

regulatory statute, where (1)self-reporting is essential to the fulfillment of its objective, (2) the burden is placed upon the general public rather than a "highly selective group inherently suspect of criminal activities," (3) the general activity is lawful and (4) the possibility of incrimination is not substantial, does not violate the Fifth Amendment privilege against self-incrimination. 402 U.S. at 427-31. *See also Albertson* v. *Subversive Activities Control Board,* 382 U.S. 70 (1965).

Significantly, the *Byers* Court cited a number of examples of disclosure requirements in the commercial and industrial sectors and made the following observation:

> In each of these situations there is some possibility of prosecution—often a very real one—for criminal offenses disclosed by or deriving from the information that the law compels a person to supply. Information reviewed by these reports could well be "a link in the chain" of evidence leading to prosecution and conviction. But under our holdings the mere possibility of incrimination is insufficient to defeat the strong policies in favor of a disclosure called for by statutes like the one challenged here.

402 U.S. at 427-28. *See Shapiro* v. *United States,* 335 U.S. 1 (1948). The same reasoning applies here.

This Court has considered a problem similar to the one presented here in *S.E.C.* v. *Radio Hill Mines Co., supra.* There, as here, the appellant had been charged with orchestrating an elaborate scheme which violated the registration and antifraud provisions of the securities laws. In upholding the validity of a preliminary injunction that required disclosure of securities transactions, the Court found it "clear that securities regulation is an 'essentially noncriminal and regulatory area of inquiry.' " 479 F.2d at 7. The Court also determined that the information that was required to be disclosed related to what was "generally a completely 'lawful activity,' " quoting *California* v. *Byers, supra,* 402 U.S. at 431, and that the disclosure was not an admission of an "inherently suspect" activity, citing *Albertson* v.

Subversive Activities Control Board, supra, 382 U.S. at 79. We think the same is true for this case. We have no doubt that the securities laws are "essentially noncriminal and regulatory" and that self-reporting is essential to the fulfillment of the central purpose of the statutory scheme. Nor do we believe the people and enterprises making the commercial and investment sectors of our economy are a "highly selective group inherently suspect of criminal activities." In addition, the sale of stock and the maintenance of peaceful labor relations are quite obviously, and quite necessarily, lawful activities. Appellants chose to engage in a lawful activity in an unlawful manner. That unlawfulness cannot now be used to excuse them from regulatory disclosure requirements, even though such disclosures could lead to criminal prosecution under other statutory schemes.

The Double Jeopardy Claim.

David Stirling and Yanowitch were indicted in the Western District of New York for violations of the Taft-Hartley Act, 29 U.S.C. §186(a)(1). Stirling pleaded guilty and Yanowitch pleaded nolo contendere.[15] They argue here that prosecution under Paragraph 16 of the indictment is barred by the double jeopardy clause of the Fifth Amendment because it depends

[15] On July 12, 1977, the United States District Court for the Western District of New York, Harold P. Burke, *Judge,* granted David Stirling and Yanowitch permission to withdraw their pleas on the ground that the government had withheld exculpatory information. Stirling and Yanowitch made this motion just prior to the trial which led to the convictions we consider on this appeal. Judge Frankel and the government were informed of the withdrawal motion. Neither the pleas nor the convictions entered in the Western District were admitted as evidence in the Southern District. Appellants now request that we dismiss this appeal without prejudice and remand it to the Southern District pending disposition of their contemplated motion for a new trial. We deny the appellants' motion. *See Fed. R. Crim. P.* 33; *United States* v. *DeSapio,* 456 F.2d 644, 647 (2d Cir.), *cert. denied,* 406 U.S. 933 (1972); *United States* v. *Sposato,* 446 F.2d 779, 781 (2d Cir. 1971).

upon the same facts underlying the Taft-Hartley prosecution. The district court properly rejected this argument.

Even if the indictment in the Western District and the indictment in the Southern District were the same "in fact," they certainly are not the same "in law." The conduct of Stirling and Yanowitch provided the basis for two separate and distinct prosecutions based upon two separate and distinct statutory schemes. The double jeopardy clause was not meant to prevent such multiple but entirely distinct prosecutions. *See United States* v. *Armedo-Sarmiento,* 545 F.2d 785,792 (2d Cir. 1976), *cert. denied,* 97 S.Ct. 1330 (1977); *United States* v. *Cala,* 521 F.2d 605, 607 (2d Cir. 1975); *United States* v. *McCall,* 489 F2d 359, 362 (2d Cir. 1973), *cert. denied,* 419 U.S. 849 (1974); *United States* v. *Sebastian,* 428 F.Supp. 967, 970-72 (W.D.N.Y. 1977).

The "Inflammatory and Prejudicial Nature" of Paragraph 16.

The Stirlings and Yanowitch argue that Paragraph 16 of the indictment should have been stricken by the district court prior to trial as being of an inflammatory and unfairly prejudicial nature and, during and after trial, for failure of proof. We reject both arguments.

Paragraph 16 of the indictment originally charged that the defendants knew but did not disclose that UBCJA officials "had been paid off by having" Homex stock purchased for them at a low price and bought back from them at a high price. Prior to trial, the Stirlings and Yanowitch moved to strike the entire paragraph under Fed. R. Crim. P. 7(d). The district court ordered the deletion of the "paid off" language; only the modified version was seen by the jury. We think decision decisison by the district judge was sound, and we see no reason why he should have gone farther and deleted the entire paragraph. The redacted paragraph was a rather bland statement of allegations regarding the failure to disclose the true nature of the relationship between Homex and UBCJA officials. *See* Fed. R. Crim. P. 7(c). This allegation was made

in a non-inflammatory fashion and it was properly included in an indictment for violation of securities laws and the mail fraud statutes.

The true nature of Homex's labor relations was important to a potential investor. Once Homex decided to make representations concerning its labor relations, it should have described them accurately. Corporate funds were being used improperly to aid in the maintenance of peaceful labor relations, a fact that investors did not know. Knowledge of the true machinations would have given a prudent investor considerable pause—labor relations would not have looked as normal as they were made to appear nor would the corporate financial practices have appeared so sound.

The purpose of an indictment is to state the charge against the accused. The accomplishment of that purpose is to some extent inherently prejudicial. On the facts before us, however, we conclude that the district court did not abuse its discretion by deciding that the indictment was not unfairly prejudicial. *See United States* v. *Courtney*, 257 F.2d 944, 947 (2d Cir. 1958), *cert. denied*, 358 U.S. 929 (1959).

Appellants also suggest that the district court erred by not striking Paragraph 16 sua sponte, either during or after trial. They claim that the facts necessary to support Paragraph 16 could not have been and were not shown. We disagree. The charge was properly included in the indictment in the first place, and at trial the government presented substantial evidence to support it. *See United States* v. *Stanchich*, 550 F.2d 1294, 1299 (2d Cir. 1977); *United States* v. *Taylor*, 464 F. 2d 240, 242-45 (2d Cir. 1972). RULE 11(e) (6).

Appellant Schulz was interviewed nine times at the United States Attorney's Office during the early stages of the Homex investigation. At first, he maintained that there were no grounds for an indictment. He was unpersuasive. In March, 1976, Assistant United States Attorney MacDonald informed Schulz that an indictment was going to be recommended.

Schulz was not pleased with this news, and he asked his attorney to meet with MacDonald. They met, and MacDonald suggested that Schulz plead guilty and testify for the government.

Schulz agreed to a negotiated plea agreement on July 15.[16] On July 16 he testified before the Grand Jury giving detailed

[16] The agreement provided in pertinent part as follows:

> On the understandings specified below, the United States will accept a guilty plea from Edwin J. Schulz to one count of an Indictment charging a violation of 18 U.S.C. §371 and carrying a maximum sentence of 5 years imprisonment and a $10,000 fine. If he fully complies with these understandings, Mr. Schulz will not be prosecuted by this Office for other existing charges known to this Office hereinafter specified, or for potential charges based upon information supplied to this Office by Mr. Schulz himself. Such immunity specifically includes charges related to securities, mail and wire frauds, perjury and false statements.
>
> The understandings are that Mr. Schulz shall truthfully disclose all information with respect to the activities of himself and others concerning all matters about which this Office inquires of him, and, further, shall truthfully testify before the Grand Jury and/or at any trial or other court proceeding with respect to any matters about which this Office may request his testimony.
>
> . . . .
>
> It is further understood that Mr. Schulz must at all times give complete, truthful and accurate information and testimony and must not commit any further crime whatsoever. Should Mr. Schulz commit any further crimes or should it be judged by this Office that Mr. Schulz has given false, incomplete or misleading testimony or information, or has otherwise violated any provision of this agreement, this agreement shall be null and void and Mr. Schulz shall thereafter be subject to prosecution for any federal criminal violation of which this Office has knowledge, including, but not limited to, perjury and obstruction of justice. Any such prosecutions may be premised upon any information provided by Mr. Schulz, and such information may be used against him.
>
> No additional promises, agreements and conditions have been entered into other than those set forth in this letter and none will be entered into unless in writing and signed by all parties.

and incriminating information regarding the activities he and his Homex colleagues had engaged in. Neither a copy of the indictment nor a commitment as to what it would contain was given to Schulz until after his Grand Jury appearance. When the indictment was finally filed on July 27, Schulz was apparently shocked that it charged him with the same nine counts as the other defendants. Apparently because of the scope of the indictment and because the indictment did not charge the Homex auditors, Schulz withdrew from the plea agreement, pleaded not guilty and went to trial. His Grand Jury testimony was admitted as evidence against him.

Schulz claims on appeal, as he did below, that his Grand Jury testimony was made "in connection with" his offer to plead guilty and therefore, under Fed. R. Crim. P. 11(e)(6),[17] should not have been allowed as evidence. Judge Frankel denied Schulz' pre-trial motion, finding that his "argument strains the language and purport of the Rule [and] has no basis in policy or significant precedent." In rejecting Schulz' motion

[17] Rule 11(e)(6) provides as follows:

> Except as otherwise provided in this paragraph, evidence of a plea of guilty, later withdrawn, or a plea of nolo contendere, or of an offer to plead guilty or nolo contendere to the crime charged or any other crime, or of statements made *in connection with, and relevant to,* any of the foregoing pleas or offers, is not admissible in any civil or criminal proceeding against the person who made the plea or offer. However, evidence of a statement made in connection with, and relevant to, a plea of guilty, later withdrawn, a plea of nolo contendere, or an offer to plead guilty or nolo contendere to the crime charged or any other crime, is admissible in a criminal proceeding for perjury or false statement if the statement was made by the defendant under oath, on the record, and in the presence of counsel. (emphasis added).

The language of Fed. R. Crim. P. 11(e)(6) and F. R. Evid. 410 is identical; their legislative histories are interconnected and complimentary. 8 Moore's Federal Practice ¶11.08 (2d ed. 1977); 2 Weinstein's Evidence ¶410; Advisory Committee Note to Rule 11(e)(6), *reprinted in* 62 F.R.D. 286 (1974); A.B.A. Standards Relating to Pleas of Guilty §3.4 (1968).

made during trial, Judge Frankel added that Schulz had lost the protection of the plea agreement by failing to plead guilty and that his suggested interpretation of the rule would work "evil consequences" by subjecting the Grand Jury and investigative processes "to all kinds of deceptive and manipulating and misleading uses." We agree.

Rule 11(e)(6) has not been applied to Grand Jury testimony given after formalization of a negotiated plea agreement and before withdrawal from that agreement.[18] Nor will we so apply it here. *See generally* 2 Weinstein's Evidence 410-1 to 410-42 (1976) for discussion of the legislative history of Rule 11(e)(6) and related authorities. The policy behind the rule is that, "for plea bargaining to work effectively and fairly, a defendant must be free to negotiate without fear that his statements will later be used against him." *United States* v. *Herman,* 544 F.2d 791, 796 (5th Cir. 1977); *United States* v. *Ross,* 493 F.2d 771, 775 (5th Cir. 1974); Advisory Committee Note to Fed. R. Evid. 410, *reprinted in* 56 F.R.D. 229 (1972). Although it is true that the language of the rule is capable of being read expansively, so as to reach Grand Jury testimony given after the plea bargaining, it is just as true that "the primary concern of the draftsmen ... was with fairly formal plea bargaining between the United States Attorney and coun-

[18] In *Hutto* v. *Ross,* 97 S.Ct. 202 (1976), *rev'g Mobley ex rel. Ross* v. *Meek,* 531 F.2d 924 (8th Cir.) (petition for writ of habeas corpus from state conviction), the Supreme Court considered the question whether a confession is per se inadmissible in a criminal trial because it was made after an agreed upon plea bargain that did not call for such a confession and before the withdrawal from the plea bargain. The Court held that it was not, and ruled that the Court of Appeals had erred when it determined that "any statement made as a result of a plea bargain is inadmissible." The Court also noted that the case did not "involve the admissibility in criminal trials of statements made during the plea negotiation process," referring to Rule 11(e)(6). *Id.* at 203 n.3. The implication, of course, is that not all statements made merely as a result of a plea bargain are excludable under Rule 11(e)(6) as statements made "in connection with, and relevant to" such a plea bargain.

sel for defendant after charges had been, *or were about to be,* made." 2 Weinstein's Evidence ¶410 [07], at 410-40 (emphasis added). The plea negotiation procedure between MacDonald and Schulz' attorneys was both fair and formal. We have no doubt that Schulz gave his testimony voluntarily, albeit because of the agreement. Thus, the rule was not meant to reach Grand Jury testimony in circumstances such as these, and we will not so extend it.[19]

Even the Court that has given the rule its most generous interpretation, the Eighth Circuit in *United States* v. *Herman, supra,* would not likely immunize Schulz's statements in these circumstances. In *Herman,* the Court held that "[s]tatements are inadmissible if made at any point during a discussion in which the defendant seeks to obtain concessions from the government in return for a plea." 544 F.2d at 797. It simply cannot be said that Schulz was engaged in a "discussion" with the Grand Jury in an attempt to obtain concessions from the government in exchange for his plea. Schulz himself concedes as much on appeal: "He was under no illusion that his testimony might persuade the grand jury not to indict him." Brief for Appellant Schulz at 34. The plea agreement had already been reached by the time Schulz went before the Grand Jury. The negotiations were over. All Schulz had to do was live up to his end of the bargain. His failure to do so justly exposed him to prosecutorial use of his Grand Jury testimony.

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[19] Judge Weinstein does suggest that a "grey area" exists regarding the admissibility under the rule of grand jury testimony that follows a negotiated plea but precedes the withdrawal of that plea when the defendant had negotiated the plea without benefit of an attorney. He concludes, however, that even under such circumstances "immunity seems unjustified." 2 Weinstein's Evidence ¶ 410[07], at 410-41. Because Schulz had the benefit of an attorney throughout the bargaining process, he would have difficulty fitting into even this grey area, if indeed one exists. *See United States* v. *Smith,* 525 F.2d 1017 (10th Cir. 1975).

We believe this is precisely the result contemplated by the parties. The agreement provided as follows:

> [S]hould it be judged by [the United States Attorney's] office that Mr. Schulz has . . . violated any provision of this agreement, this agreement shall be null and void and Mr. Schulz shall thereafter be subject to prosecution for any federal criminal violation . . . . Any such prosecutions may be premised upon any information provided by Mr. Schulz, and such information may be used against him.

This language is hardly ambiguous. We agree with the district court that Schulz agreed to plead guilty in exchange for the protections contained in the agreement. We also think it apparent that the agreement contemplated prosecutorial use of the information provided by Schulz in the event that the guilty plea was not entered.

It may be true that Schulz would not have testified before the Grand Jury had it not been for the plea agreement, but this is not in itself sufficient for suppression of that testimony under Rule 11(e)(6). Schulz voluntarily negotiated his plea agreement, voluntarily appeared before the Grand Jury, and voluntarily decided to violate his plea agreement. He could have relied on the agreement to protect himself. *See Santobello* v. *New York,* 404 U.S. 257 (1971); *United States* v. *Scharf,* 551 F.2d 1124, 1126 n.4 (8th Cir.), *cert. denied,* 46 U.S.L.W. 3215 (U.S. Oct. 3, 1977) ("There is no question that a breach of a plea bargain by the government, if established, may entitle a defendant who has pleaded guilty in reliance on the bargain to appropriate relief."). His breach of the agreement removed that protection. Such a result can hardly be said to undercut the confidence and candor needed for successful and fair plea negotiations. It simply means that once the agreement is finalized its terms will be enforced.

Severance.

Appellant Phillips, the central figure in the Mississippi Greater Gulf scheme, argues that the district court erred by

refusing to grant his mid-trial Rule 14 motion to sever his trial from that of the other defendants.[20] Essentially, he claims that the indictment charged, and the evidence showed, multiple conspiracies rather than a single conspiracy, that he was, at most, involved in only one of those conspiracies and that the forced combination of his trial with that of the others operated to his substantial prejudice. We disagree.

First, we reject Phillips' argument that the indictment charged, and the evidence showed, multiple conspiracies. The indictment charged a single conspiracy, the "essential nature" of which was the fraudulent inflation of Homex's reported income and the intentional concealment of material information adverse to Homex. *Compare United States* v. *Rosenblatt*, 554 F.2d 36, 38 (2d Cir. 1977). That the indictment alleged a variety of devices intended to accomplish this objective, devices carried out by a variety of individuals, does not alter the fundamental nature of the indictment itself. Thus, the question is whether the government established the existence of the alleged conspiracy. This is a matter "primarily for the jury, since it is a question of fact as to the nature of the agreement." *United States* v. *Finkelstein*, 526 F.2d 517, 522 (2d Cir. 1975), *cert. denied*, 425 U.S. 960 (1976); *United States* v. *Armedo-*

[20] Fed. R. Crim. P. 14 provides in pertinent part as follows:

> If it appears that a defendant or the government is prejudiced by a joinder of offenses or of defendants in an indictment or information or by such joinder for trial together, the court may order an election or separate trials of counts, grant a severance of defendants or provide whatever other relief justice requires.

Phillips' attorney broached the question of severance prior to trial, but decided not to make the motion at that time. The record shows that he believed the joinder of defendants under Fed. R. Crim. P. 8 was probably appropriate, but that he wished to reserve the possibility of moving for severance as the trial proceeded. The district court authorized counsel to make the motion at a later time. *See* Fed. R. Crim. P. 12(b)(5); 8 Moore's Federal Practice ¶14.02[2] (2d ed. 1977).

Sarmiento, 545 F.2d 785, 789 (2d Cri. 1976), *cert. denied*, 97 S.Ct. 1330 (1977). "Our task on review is to determine whether the legal standard given to the jury by the trial court in its charge was correct and whether, viewing the proof in the light most favorable to the Government, there was sufficient evidence to permit the jury to find the single conspiracy alleged." *United States* v. *Taylor*, *supra*, 562 F.2d 1345, 1351 (2d Cir.), *cert. denied*, 97 S.Ct. 2958 (1977). Here, Phillips did not even request a jury instruction on the difference between single and multiple conspiracies, nor did he object to the charge that was eventually given. Moreover, the charge that was delivered was a fair one—it made clear that guilt was to be found on an individual basis and it focused on the fact that Phillips was not named in various specifications of the indictment. Given this, and given the overwhelming mass of evidence establishing the existence of a broad conspiracy aimed at accomplishing an unlawful objective, we cannot agree that there were multiple conspiracies or that Phillips was entitled to severance on that basis.

Thus, the real question is not whether there was a misjoinder under the liberal provisions of Fed. R. Crim. P. 8,[21] but

[21] Fed R. Crim. P. 8 provides as follows:

> (a) Joinder of Offenses. Two or more offenses may be charged in the same indictment or information in a separate count for each offense if the offenses charged, whether felonies or misdemeanors or both, are of the same or similar character or are based on the same act or transaction or on two or more acts or transactions connected together or constituting parts of a common scheme or plan.
>
> (b) Joinder of Defendants. Two or more defendants may be charged in the same indictment or information if they are alleged to have participated in the same act or transaction or in the same series of acts or transactions constituting an offense or offenses. Such defendants may be charged in one or more counts together or separately and all of the defendants need not be charged in each count.

whether the refusal of the district court to sever Phillips from the main trial was so unfairly prejudicial under Rule 14 as to constitute an abuse of discretion. This is a difficult burden for Phillips to meet. "The determination of the elusive criterion of prejudice rests in judicial discretion at the trial level, and is virtually unreviewable." 8 Moore's Federal Practice ¶ 14.02[1], at 14-3 (2d ed. 1977) (footnote omitted). While we do not shirk our responsibility of review, we are reluctant to overturn a conviction for denial of a motion for severance unless there is a showing of substantial prejudice. *United States* v. *Miley*, 513 F.2d 1191, 1209 (2d Cir.), *cert. denied*, 423 U.S. 842 (1975). It is not sufficient merely to show that the accused would have had a better chance for acquittal at a separate trial. *United States* v. *Corr*, 543 F.2d 1042, 1052 (2d Cir. 1976); 8 Moore's Federal Practice ¶ 14.04[1], at 14-14.2 to 14-15 (2d ed. 1977).

Phillips was charged with playing a significant and knowing role in the advancement of the objective of the conspiracy. Although he was not charged with having participated in every detail of that conspiracy, we have no doubt that he was properly tried with the other conspirators. He played the key role in orchestrating the most blatant misrepresentation in the entire Homex drama, the Greater Gulf project. The public interest in avoiding unnecessarily multiplicitous litigation was well-served by the district court's decision. We hold that Phillips was not prejudiced by the denial of the motion, nor was its denial an abuse of discretion.

William Stirling's Motion for Acquittal.

William Stirling argues that the district court erred by denying his Rule 29 motion for judgment of acquittal. He claims that the evidence showed no more than that he was "the head of production at Homex, a craftsman whose talent ran to assembling prefabricated homes with cranes, rather than the alleged fabricating of financial statements" and that "all his alleged activities were more likely the result of brotherly trust

than a desire to defraud." He characterizes the evidence against him as "paltry." The district court believed that this argument was non-frivolous but determined that a jury question existed. We agree.

A motion for judgment of acquittal is governed by Fed. R. Crim. P. 29, which provides that a judgment of acquittal shall be entered "if the evidence is insufficient to sustain a conviction." *See generally* 8A Moore's Federal Practice ¶ 29.01 to 29.09 (1977). The question, therefore, is whether the evidence was sufficient. *See Id.* ¶ 29.06. We determine this by asking

> whether upon the evidence, giving full play to the right of the jury to determine credibility, weigh the evidence, and draw justifiable inferences of fact, a reasonable mind might fairly conclude guilt beyond a reasonable doubt.

United States v. *Taylor*, 464 F.2d 240, 243, 242-45 (2d Cir. 1972), *quoting*, *Curley* v. *United States*, 160 F.2d 229, 232 (D.C. Cir.), *cert. denied*, 331 U.S. 837 (1947). In *Curley*, the District of Columbia Circuit said that if the district court "concludes that either of the two results, a reasonable doubt or no reasonable doubt, is fairly possible, [it] must let the jury decide the matter." 160 F.2d at 233. This, coupled with the requirement that we view the evidence in the light most favorable to the government, *Glasser* v. *United States*, 315 U.S. 60, 80 (1942), leaves us with no doubt that the district court was correct.

William Stirling was founder, President, Chief Operating Officer and Director of Homex. His participation in the creation and management of Homex was constant and comprehensive. Without going through the entire Homex story again, we need only say that there was ample evidence to warrant submitting to the jury the question whether William Stirling was an active and knowing participant in the fraud schemes and conspiracy. *See United States* v. *Amrep Corp.*, *supra*.

The Prosecutors' Summation.

William Stirling argues that he should be granted a new trial based upon allegedly prejudicial comments made by the prosecutor during rebuttal summation. He claims that the prosecutor misstated the testimony of two witnesses and improperly raised the matter of his use of Homex expense accounts. The district court went out of its way to compliment all of the attorneys on their summations. Appellant Stirling found no fault with the rebuttal summation when it was given. We agree with the district court's evaluation. In our view, nothing in the prosecutor's comments constitutes plain error. Fed. R. Crim. P. 52(b); *see United States* v. *Canniff*, 521 F.2d 565, 572 (2d Cir. 1975), *cert. denied*, 423 U.S. 1059 (1976); *United States* v. *Perez*, 426 F.2d 1073, 1081 (2d Cir. 1970), *aff'd*, 402 U.S. 146 (1971).

Miscellany.

The Stirlings and Yanowitch make five additional arguments that we now consider briefly. First, they argue that the district court committed reversible error by telling the jury that it might have heard perjury during the trial and that it should consider the interests of the witnesses in evaluating testimony. They argue that this remark was directed to their testimony.

Specifically, they claim that the following portions of the jury instruction constitute error:

> Now to go to. . .the subject of credibility of witnesses. That is a key problem for juries. I think it is reasonably safe to suggest that you probably heard more than once perjury from the witness stand in this case. Beyond that, of course, you have heard lots of conflicting statements about what happened or didn't happen, about what was said or was not said, and you are relying on the net effect of those witnesses in the last analysis for your discovery of the truth, for your accurate recreation of the events upon which you

> will base an accurate and just decision, and that is the problem of credibility.
>
> . . . .
>
> Among interested people who testified you have heard three of the defendants themselves, and you would know without my saying that a defendant in a criminal case has a deep and profound and abiding interest in the outcome of that case. Obviously that is among the factors you will take into account in appraising the credibility of those witnesses.
>
> . . . .
>
> In considering whether [cooperating witnesses] may have sworn falsely in this respect, you may also take into account that the cases at least where immunity has been granted, the immunity has been conditioned on the undertaking of the witness to tell only the truth here and elsewhere with the stipulation that the immunity would end if the person was deemed to testify falsely, and you may weigh that with and against the several other things that I have mentioned.

The district court prefaced its instruction with the remark that it had no view on the issues and that its instructions were not to be used as indicators of its opinion. Because no objections to the charge were made by the appellants, they are barred from raising them now. Fed. R. Crim. P. 30; *United States* v. *Nathan*, 536 F.2d 988, 992 (2d Cir.), *cert. denied*, 97 S.Ct. 337 (1976). Even if objection had been made, the instruction was fair and proper. *See United States* v. *Cheung Kin Ping*, 555 F.2d 1069, 1074 (2d Cir. 1977); *United States* v. *Floyd*, 555 F.2d 45, 47 (2d Cir. 1977); *United States* v. *Lombardi*, 550 F.2d 827,829 (2d Cir. 1977); *United States* v. *Tolkow*, 532 F.2d 853, 859 (2d Cir. 1976). It was certainly not plain error. Fed. R. Crim. P. 52(b).

Second, they argue that the charge given by the district court regarding reliance on experts was erroneous. The court charged as follows:

> If an attorney or an accountant has a full account of the facts of what you are doing and what you intend to do and then says it is proper, it is lawful, your proceeding on that basis might serve as a strong indication that you were acting in good faith and not in bad faith.
>
> On the other hand, you will realize that if some of the important facts are mis-stated to the accountant or lawyer or if some of the important information is withheld and not disclosed, the advice that the accountant or lawyer then gives can hardly be deemed to constitute a basis for claiming good faith in going ahead and acting on the basis of that uninformed and insufficiently implemented advice.

Appellants claim they were entitled to an instruction that the failure of Homex attorneys, auditors and labor experts to ask them sufficiently probing questions releases them from responsibility for whatever omissions and false statements they made after consulting with those experts. Such an instruction would stand the defense of good faith on its head. The appellants' experts had no obligation to ferret out proof of wrongdoing. If they were not fully informed, their lack of information can hardly be used as a defense by those who chose to keep them uninformed. *United States* v. *Tolkow*, *supra*, 532 F.2d at 857; *United States* v. *Smith*, 523 F.2d 771, 778 (5th Cir. 1975), *cert. denied*, ____S.Ct.____ ( ).

Third, they argue that they were prejudiced by the district court's decision to bar questions put by them to their witnesses regarding the "normalcy" or "usualness" of certain Greater Gulf practices. The district court instructed counsel not to ask witnesses about "the legal consequences of things," such as whether activities were "wrong," "misleading," "proper," or "ethical." For example, in response to a question from counsel for the appellants, a state court judge from Mississippi testified

that because prominent people with good reputations were involved in Greater Gulf, he assumed that it was "normal" for a non-profit corporation to be used to implement the project. Such testimony is not even arguably admissible. It would have been an abdication of responsibility if the trial judge had not interrupted, as he did, to instruct counsel not to ask such questions. The "normalcy" of Greater Gulf practices was irrelevant to the failure to disclose Homex's relationship with Greater Gulf. Even if it were relevant, the witness' speculations, based on the reputations of those involved, would not be probative on that issue. Fed. R. Evid. 404. And even if it were probative, such evidence should not have been sought to be introduced through a sitting judge. Its potential for unfair prejudice to the government quite plainly outweighs its negligible probative value. Fed. R. Evid. 403. Finally, although counsel insisted on making unnecessary "exceptions" to the district court's instructions, he completely failed to make an offer of proof as required by Rule 103(a)(2). The context in which the rulings were made does not disclose the substance of any evidence—aside from the inadmissible "normalcy" evidence that was admitted in any event—that counsel wished to bring out. Counsel's explanation of his purpose was, at best, confusing, and, in view of the answer he had just obtained, it was hardly a sufficient basis upon which to predicate a claim of error.

Fourth, they argue that the district court erred by excluding Daniel Wind as a defense witness. They claim Wind would have disclosed that, on the eve of the Homex bankruptcy, he was negotiating with Homex on behalf of the State of Israel for a purchase of modules. This testimony apparently would have been used to respond to evidence proffered by the prosecution tending to show that there were at the time of bankruptcy "few if any viable projects in the works." We reject appellant's claims. That negotiations were taking place at the very close of the Homex drama was irrelevant—negotiations were apparently always taking place. The point of the Homex prosecution was not to deny the existence of negotiations, even

successful ones, but to show that the investing public had been defrauded. The jury was carefully reminded of the fact that Homex had indeed made genuine sales.

Finally, they argue that the district court erred in excluding one Peter Turzik, a former UBCJA official, as a surrebuttal witness. They claim that Turzik would have testified that a prosecution rebuttal witness, Theodore Kheel, had lied when he denied having arranged for the purchase of Homex stock by UBCJA officials. Appellants had a reasonable chance to challenge Kheel's testimony regarding Turzik by confronting him with seemingly contradictory grand jury testimony. In addition, the district court at the same time allowed Joseph Kirkland, one of the labor officials who purchased Homex stock, to testify in surrebuttal to much the same effect that Turzik would have. Further evidence would have been cumulative. We can hardly say that the district court abused its discretion in this regard. *See* Fed. R. Evid. 403. Nor can we say that the district court's decision operated to appellants' substantial prejudice.

V. CONCLUSION

The motion to dismiss the appeal and remand to the district court is denied. *See* note 15 *supra*. Judgements of conviction are affirmed.

LUMBARD, *Circuit Judge* (concurring):

I concur in the affirmance of all the convictions, substantially for the reasons stated in Judge Meskill's opinion. In addition, I wish to state my views regarding Schulz's complaint about the government's use at trial of his grand jury testimony.

Schulz seeks reversal of his conviction on the ground that it was error for the district court to submit into evidence testimony Schulz had given to the grand jury prior to his indictment. This testimony was given pursuant to an agreement that Schulz, acting through his attorney, had entered into with the prosecutor, under the terms of which Schulz was to plead guilty and testify for the government both before the grand jury and at trial. In addition, the agreement specifically provided, as Judge Frankel found, that if Schulz failed to perform as promised, then any information he had given could be used against him.

In denying Schulz's motion at trial to suppress his grand jury testimony, Judge Frankel noted that Schulz had testified, "voluntarily for his own good, at a time when he had agreed to plead guilty to one count." Judge Frankel concluded that under these circumstances Fed. R. Crim. P. 11(e) (6) did not require suppression and that the government had never agreed to suppression under any circumstances. The record amply supports these findings.

Rule 11(e) (6) does not apply here. The written agreement entered into by the government and Schulz's attorney prior so Schulz's grand jury appearance plainly anticipated that, should Schulz renege—as he did by going back on his promise to plead guilty—then his testimony could be used at his

trial. The purpose of Rule 11(e) (6) is to encourage plea negotiations leading to the prompt dispositon of criminal charges by means other than trial. See *United States v. Smith*, 525 F.2d 1017, 1020 (10th Cir. 1975); 2 J. Weinstein & M. Berger, Weinstein's Evidence ¶ 410[03] (1976). Thus, the rule has no application where a plea agreement has already been made which specifically addresses the question of subsequent use of information given pursuant to the agreement.

From the standpoint of the government, the obvious purpose of such an agreement is to enable the prosecutor to pursue his investigation and preparation for the presentation of evidence in such a way that the time and expense spent in negotiations and discussions will not be fruitless. Such safeguarding of government resources is all the more necessary because the government must comply with the increasingly stringent time schedule mandated by the Speedy Trial Act of 1974, 18 U.S.C. §3161 to §3174.

Of course nothing turns on whether Schulz's statements were made before a grand jury. No matter where or how made, any statements made by Schulz pursuant to the agreement could have been used by the government at his trial.

For these reasons, the district court did not err in admitting Schulz's grand jury testimony.

APPENDIX B

JUDGMENT OF THE COURT OF APPEALS

United States Court of Appeals

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the second day of February one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD

HON. JAMES L. OAKES

HON. THOMAS J. MESKILL

Circuit Judges,

UNITED STATES OF AMERICA, *Plaintiff-Appellee* v. DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBEL L. PHILLIPS, *Defendants-Appellants.*	**77-1144** **77-1178** **77-1140** **77-1141** **77-1177**

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgements of said District Court be and they are hereby affirmed in accordance with the opinion of this court.

It is further ordered that the motion to dismiss the appeal and remand to the district court be and it hereby is denied.

A. DANIEL FUSARO,
Clerk

By ARTHUR HELLER
Deputy Clerk

APPENDIX C

DENIAL OF REHEARING BY THE COURT OF APPEALS

United States Court of Appeals

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the thirteenth day of April, one thousand nine hundred and seventy-eight.

UNITED STATES OF AMERICA, *Plaintiff-Appellee,* v. DAVID STIRLING JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ, and RUBEL L. PHILLIPS, *Defendants-Appellants.*	77-1140 77-1141 77-1144 77-1177 77-1178

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the defendants-appellants, David Stirling, William G. Stirling and Harold M. Yanowitch, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is Ordered that said petition be and it hereby is DENIED.

IRVING R. KAUFMAN

Chief Judge
IRVING R. KAUFMAN

United States Court of Appeals

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the thirteenth day of April, one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD

HON. JAMES L. OAKES

HON. THOMAS J. MESKILL

Circuit Judges.

UNITED STATES OF AMERICA, *Plaintiff-Appellee,*	
v.	77-1140
	77-1141
DAVID STIRLING JR., WILLIAM G. STIRLING,	77-1144
HAROLD M. YANOWITCH, EDWIN J. SCHULZ, and	77-1177
RUBEL L. PHILLIPS, *Defendants-Appellants,*	77-1178

A petition for a rehearing having been filed herein by counsel for the defendant-appellants, David Stirling, William Stirling, and Harold M. Yanowitch,

Upon consideration thereof, it is Ordered that said petition be and hereby is DENIED.

A. DANIEL FUSARO

A. Daniel Fusaro
Clerk

APPENDIX D

INDICTMENT

United States District Court

SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA

v.

DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ, and RUBEL L. PHILLIPS,

Defendants.

INDICTMENT
76 Cr. 685
(MEF)

COUNT ONE

The Grand Jury charges:

INTRODUCTION

1. At all relevant times, the Stirling Homex Corporation ("Homex") was incorporated under the laws of the State of Delaware and maintained offices in the Southern District of New York and elsewhere. Homex was principally engaged in the business of manufacturing and installing factory-built modular housing.

2. On or about February 19, 1970, Homex registered 1,175,000 shares of its common stock for sale with the Securities and Exchange Commission ("SEC"), an agency of the United States, and sold that stock to members of the public for approximately $19,000,000; on or about July 29, 1971, Homex registered 500,000 shares of its preferred stock for sale with the SEC and sold that stock to members of the public for approximately $20,000,000; thereafter there existed in New York, New York, and elsewhere, a public over-the-counter market for Homex common and preferred stock. Less than a year later, on July 12, 1972, Homex was bankrupt.

3. At all relevant times, defendant DAVID STIRLING, JR., was the chief executive officer of Homex, chairman of its board

of directors and the owner of a controlling block of approximately 2,000,000 shares of Homex common stock. On February 19, 1970, he sold 110,100 shares of his Homex common stock for approximately $1,600,000.

4. At all relevant times, defendant WILLIAM G. STIRLING was the president of Homex, a member of its board of directors and the owner of a controlling block of approximately 2,000,000 shares of Homex common stock. On February 19, 1970, he sold 112,000 shares of his Homex common stock for approximately $1,700,000.

5. Beginning in or about 1968 and at all relevant times thereafter, defendant EDWIN J. SCHULZ was an employee of Homex, its chief accounting officer and the owner of 3,200 shares of Homex common stock.

6. Beginning in or about 1969, and at all relevant times thereafter, defendant HAROLD M. YANOWITCH, an attorney, was an employee of Homex, a member of its board of directors, its chief legal officer and the owner of approximately 160,000 shares of Homex common stock.

7. Beginning in or about 1971, and at all relevant times thereafter, defendant RUBEL L. PHILLIPS, an attorney, was an employee of Homex with an office in Jackson, Mississippi and the owner of an option to purchase 40,000 shares of Homex common stock.

I. FRAUD SCHEME

8. From on or about the 1st day of January, 1968, and continuously thereafter up to and including the date of the filing of this Indictment, in the Southern District of New York and elsewhere, DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBEL L. PHILLIPS, the defendants, and others to the Grand Jury known and unknown, did employ a device, scheme, and artifice to defraud Homex's shareholders, officers, directors and others

including its auditors, in connection with the offer and sale of securities, to wit, common and preferred stock of Stirling Homex Corporation.

II. THE OBJECT OF THE SCHEME

9. It was the object of said scheme deliberately to deceive members of the public investing in Homex securities by fraudulently inflating reported earnings and simultaneously falsifying and concealing materially adverse information required to have been fairly and truly disclosed.

III. THE MEANS BY WHICH THE FRAUD SCHEME WAS CARRIED OUT

10. It was a part of said scheme to defraud that in 1969, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH and EDWIN J. SCHULZ falsely inflated revenues and profits by arranging two "sales" of land at artificially high prices that were induced by and based upon side promises and guarantees given to the buyers. In connection therewith, the defendants signed and filed registration statements with the SEC which fraudulently concealed the following essential facts, among others, about these "sales" which accounted for 18% of net income for the fiscal year ending July 31, 1969: (a) both "sales" involved side promises and agreements given to the buyers including limitations on and guarantees against losses; (b) both "sales" required only minimal down payments with the remainder of the purchase payment being largely postponed for several years; and (c) both "sales" were to financially weak shell corporations without sufficient means to meet the payment obligations.

11. It was further a part of said scheme to defraud that during 1970 and 1971 the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, and EDWIN J. SCHULZ, would prepare, file with the SEC, and distribute to shareholders annual and interim reports which fraudulently omitted to disclose, among other things: (a) that such "sales" were not being consumated; (b) that in one instance, persons affiliated with or controlled by Homex were substituted as owners of the shell corporation and were secretly guaranteed against losses and indirectly provided with Homex funds to make periodic payments toward the unpaid purchase obligation; and (c) that the payment obligations arising from these "sales" were in fact uncollectible.

12. It was further a part of said scheme to defraud that in 1971 the defendant, DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, and EDWIN J. SCHULZ falsely inflated revenues and profits by arranging a third "sale" of land at an artificially high price that was induced by and based upon secret promises and guarantees given to the buyers. In connection therewith, the defendants prepared and filed registration statements and quarterly reports with the SEC which fraudulent[ly] concealed the following essential facts, among others, about this "sale" which accounted for nearly half of Homex's earnings for the first half of the fiscal year ending July 31, 1971: (a) that such "sale" involved side promises and agreements given to the buyers including guarantees against losses; (b) that such "sale" involved only a minimal downpayment, borrowed through the use of Homex collateral, with the remainder of the purchase payment being postponed several years; (c) that such "sale" was at a price which had been artificially raised; and (d) that such "sale" was to a financially weak shell corporation, without sufficient means to meet the payment obligations, and which was owned by individuals associated with a business which, in turn, had derived a material portion of its past revenues from dealings with Homex.

13. It was further a part of said scheme to defraud that in or about July 1971, defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH and EDWIN J. SCHULZ prepared, signed and filed with the SEC registration statements and other written representations which falsely and fraudulently stated that Homex recognized income from sales of modules when manufactured modules were assigned to specific contracts. That representation was false because, as the defendants well knew, such assignments had been repeatedly cancelled or reversed with the modules then being reassigned from project to project until, for example, by February 28, 1971, a total of approximately $13,500,000 of such sales had been written on and off and back onto Homex's books of account. This history of mass reassignments was deliberately withheld from both Homex's auditors and the SEC.

14. It was further a part of said scheme to defraud that during 1971 defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULTZ, and RUBEL L. PHILLIPS fraudulently and falsely inflated Homex's sales and earnings by arranging for a purported arms-length "sale" of modules for $15,000,000 which was induced by and based upon a forged commitment letter and by secret side promises and agreements given to the buyers. In connection therewith, the defendants prepared and filed registration statements and other reports with the SEC which fraudulently concealed the following essential facts, among others, about this "sale" which accounted for more than half of Homex's earnings for the nine-months ended April 30, 1971, and all of its earnings for the six months ended January 31, 1971: (1) that such "sale" was based upon a back dated contract not entered into until on or about February 24, 1971, well after the relevant accounting period had ended; (b) that, while said "sales" contract was expressly conditioned on Homex's manufacturing the modules in Mississippi and Homex's obtaining federal funding, in point of fact, Homex had not satisfied either condition; (c) that the purchaser was a financially weak shell corporation, without sufficient means to meet the payment

obligations, which Homex had caused to be formed in the first place; and (d) that, during March, 1971, the defendant HAROLD M. YANOWITCH, had employed the forged commitment letter to defraud Homex's auditors into certifying its financial statements.

15. It was further a part of said scheme to defraud that defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ, and RUBEL L. PHILLIPS fraudulently and falsely inflated and overstated Homex's publicly reported assets, revenues and earnings while also fraudulently understating its liabilities, reserves and expenses. In connection therewith, the defendants deliberately falsified and concealed from Homex's auditors material information as to adjustments in its accounts including those relating to: (a) installation division revenues and costs for the period ending July 31, 1970; (b) U.S. Shelter revenues for the period ending February 28, 1971; and (c) deferred, general and administrative expenses for the period ending February 28, 1971.

16. It was further a part of said scheme to defraud that on or about July 29, 1971, defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, and HAROLD M. YANOWITCH prepared and filed with the SEC registration statements and other reports which described Homex's several relations with the United Brotherhood of Carpenters and Joiners of America and its locals. Those statements were materially false and misleading, because as the defendants well knew, but failed to disclose, seven members and officials of the United Brotherhood of Carpenters and Joiners of America had had approximately $240,000 worth of Homex common stock purchased for them at approximately $76,800 less than the fair market value, and afterwards, when the fair market price had fallen, approximately $64,000 worth of Homex common stock sold for them at approximately $136,000 above the market price.

IV. STATUTORY ALLEGATIONS

17. From on or about the lst day of January 1968, up to and including the date of the filing of this Indictment, in the Southern District of New York and elsewhere, the defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ, and RUBEL L. PHILLIPS, and others to the Grand Jury known and unknown, unlawfully, wilfully and knowingly, by the use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly, in the offer and sale of securities, to wit, the common and preferred stock of Stirling Homex Corporation: (a) did employ devices, schemes and artifices to defraud; (b) did obtain money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and (c) did engage in transactions, practices and courses of business which operated and would operate as a fraud and deceit upon the purchasers of Stirling Homex Corporation securities.

(Title 15, United States Code, Sections 77q(a) and 77x and Title 18, United States Code, Section 2.).

COUNT TWO

The Grand Jury further charges:

1. On or about July 29, 1971, in the Southern District of New York, defendants DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBEL L. PHILLIPS, unlawfully, wilfully and knowingly made and caused to be made untrue statements of material facts in a registration statement and omitted to state material facts required to be stated therein and necessary in order to make the statements therein not misleading.

2. Said registration statement as amended covered 500,000 shares of Homex preferred stock and was required to

be filed and was filed with the SEC pursuant to Title 15, United States Code, Sections 77e through 77h and 17 C.F.R. §§ 230.400 to 230.499 and 239.11 promulgated by the SEC thereunder.

3. Each of the allegations in Count One of this Indictment is incorporated and realleged in this Count as if fully set forth herein.

(Title 15, United States Code, Section 77x and Title 18, United States Code, Section 2.).

COUNTS THREE THROUGH EIGHT

The Grand Jury further charges:

1. From on or about January 1, 1968, up to and including the date of the filing of this Indictment, in the Southern District of New York and elsewhere, DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWARD J. SCHULZ, and RUBEL L. PHILLIPS, the defendants, and others to the Grand Jury known and unknown, unlawfully, wilfully and knowingly did devise and intend to devise a scheme and artifice to defraud the purchasers of Stirling Homex Corporation securities and other persons, and to obtain money and property by means of false and fraudulent pretenses, representations and promises and, for the purpose of executing said scheme and artifice to defraud and attempting so to do, did place and cause to be placed in post offices and authorized depositories for mail matter, did take and receive therefrom, and did cause to be delivered by mail according to the directions thereon certain mail matter to be sent and delivered by the Postal Service as hereinafter set forth.

2. Each of the allegations contained in Count One of this indictment is repeated and realleged as though fully set forth herein as constituting and describing the means by which the defendants committed the offenses charged in Counts Three through Eight of this Indictment.

3. On or about the dates hereinafter set forth in Counts Three through Eight of this Indictment, in the Southern District of New York, said defendants unlawfully, wilfully and knowingly did place and caused to be placed in post offices and authorized depositories for mail and did cause to be delivered by mail according to the directions thereon, the matter hereinafter set forth:

Count	Date	Matter	Addressee
3	8/2/71	Prospectus	Peter R. Cottrell & Mary Lee Cottrell, JT TEN 115 Clinton Street Mount Vernon, N.Y. 10552
4	8/2/71	Prospectus	Ronald J. Benice & Doris P. Benice 25 Stewart Place Mt. Eisco, N.Y.
5	10/8/71	1971 Annual Report	Joseph Szymanski 200 West 18th St. New York, New York
6	10/8/71	1971 Annual Report	Peter R. Cottrell & Mary Lee Cottrell, JT TEN 115 Clinton Street Mount Vernon, N.Y. 10552
7	12/6/71	Quarterly Report to Shareholders	Joseph Szymanski 200 West 18th Street New York, N.Y.
8	12/6/71	Quarterly Report to Shareholders	Nobumitsu Fukui 53 Greene Street New York, N.Y. 10013

(Title 18, United States Code, Sections 1341 and 2.)

COUNT NINE

The Grand Jury further charges:

1. From on or about the first day of January 1968, and continuously thereafter up to and including the date of the

filing of this Indictment, in the Southern District of New York and elsewhere, DAVID STIRLING, JR., WILLIAM G. STIRLING, HAROLD M. YANOWITCH, EDWIN J. SCHULZ and RUBEL L. PHILLIPS, the defendants, and others to the Grand Jury both known and unknown, unlawfully, wilfully and knowingly did combine, conspire, confederate and agree together and with each other to defraud the United States and the SEC and to violate Sections 1001 and 1341 of Title 18 and Sections 77q(a), 77x, and 78ff of Title 15, United States Code.

2. It was a part of said conspiracy that the defendants unlawfully, knowingly and wilfully, in matters within the jurisdiction of departments and agencies of the United States, would and did falsify, conceal and cover up by trick, scheme and device material facts, and make false, fictitious and frauduent statements and representations, and make and use false writings and documents knowing the same to contain false, fictitious and frudulent statements and entries in violation of Section 1001 of Title 18, United States Code.

3. It was a further part of said conspiracy that the defendants unlawfully, wilfully and knowingly, would and did devise and intend to devise a scheme and artifice to defraud the purchasers of Stirling Homex Corporation securities and other persons, and to obtain money and property by means of false and fraudulent pretenses, representations and promises and, for the purpose of executing said scheme and artifice to defraud and attempting so to do, would and did place and cause to be placed in post offices and authorized depositories for mail matter, take and receive therefrom, and cause to be delivered by mail according to the directions thereon certain mail matter to be sent and delivered by the Postal Service in violation of Section 1341 of Title 18, United States Code.

4. It was further a part of said conspiracy that the defendants unlawfully, wilfully and knowingly, by use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly, in the offer and sale of securities, to wit, the common

and preferred stock of Stirling Homex Corporation: (a) did employ devices, schemes and artifices to defraud; (b) did obtain money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and (c) did engage in transactions, practices and courses of business which operated and would operate as a fraud and deceit upon the purchasers of Stirling Homex Corporation securities in violation of Section 77q(a) of Title 15, United States Code.

5. It was further a part of said conspiracy that the defendants unlawfully, wilfully and knowingly would and did make untrue statements of material facts in registration statements required to be filed with the SEC and omitted to state material facts required to be stated therein and necessary in order to make the statements therein not misleading in violation of Section 77x of Title 15, United States Code.

6. It was further a part of said conspiracy that the defendants unlawfully, wilfully and knowingly would and did make false and misleading statements with respect to material facts in annual and quarterly reports required to be filed with the SEC in violation of Section 78ff of Title 15, United States Code.

OVERT ACTS

1. Each of the allegations contained in Count One of this Indictment is repeated and realleged as though fully set forth herein as constituting and describing some of the overt acts by which the defendants committed the offense charged in Count Nine of this Indictment. In addition, in furtherance of the said conspiracy and to effect the objects thereof, the defendants did commit the following additional overt acts, among others, in the Southern District of New York and elsewhere:

(1) On or about August 5, 1971, defendant HAROLD M. YANOWITCH attended a closing in New York, New York where the $19,000,000 from the sale of the preferred stock was paid.

(2) On or about December 6, 1971, DAVID STIRLING, JR., and WILLIAM G. STIRLING signed and caused to be delivered in the Southern District of New York a quarterly report to shareholders.

(Title 18, United States Code, Section 371.)

FOREMAN

ROBERT B. FISKE, JR.
United States Attorney

APPENDIX E

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

UNITED STATES CONSTITUTION

AMENDMENT V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

15 UNITED STATES CODE § 77q

Fraudulent interstate transactions

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 77c of this title shall not apply to the provisions of this section.

15 UNITED STATES CODE § 77x

Penalties

Any person who willfully violates any of the provisions of this subchapter, or the rules and regulations promulgated by the Commission under authority thereof, or any person who willfully, in a registration statement filed under this subchapter, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $10,000 or imprisoned not more than five years, or both.

15 UNITED STATES CODE § 78ff

Penalties

(a) Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required

under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to ge filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than five years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

(b) Any issuer which fails to file information, documents, or reports required to be filed under subsection (d) of section 78*o* of this title or any rule or regulation thereunder shall forfeit to the United States the sum of $100 for each and every day such failure to file shall continue. Such forfeiture, which shall be in lieu of any criminal penalty for such failure to file which might be deemed to arise under subsection (a) of this section, shall be payable into the Treasury of the United States and shall be recoverable in a civil suit in the name of the United States.

18 UNITED STATES CODE § 371

Conspiracy to commit offense or to defraud United States

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose,

and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor.

18 UNITED STATES CODE § 1001

Statements or entries generally

Whoever, in any matter within the jurisdiction of any department or agency of the United States knowlingly and willfully falsifies, conseals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both.

18 UNITED STATES CODE § 1341

Frauds and swindles

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any

matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

29 UNITED STATES CODE § 186(a), (d)

Restrictions on payments and loans to employee representatives, labor organizations, officers and employees of labor organizations, and to employees or groups or committees of employees; exceptions; penalties; jurisdiction; effective date; exception of certain trust funds

(a) It shall be unlawful for any employer or association of employers or any person who acts as a labor relations expert, adviser, or consultant to an employer or who acts in the interest of an employer to pay, lend, or deliver, or agree to pay, lend, or deliver, any money or other thing of value—

(1) to any representative of any of his employees who are employed in an industry affecting commerce; or

(2) to any labor organization, or any officer or employee thereof, which represents, seeks to represent, or would admit to membership, any of the employees of such employer who are employed in an industry affecting commerce; or

(3) to any employee or group or committee of employees of such employer employed in an industry affecting commerce in excess of their normal compensation for the purpose of causing such employee or group or committee directly or indirectly to influence any other employees in the exercise of the right to organize and

bargain collectively through representatives of their own choosing; or

(4) to any officer or employee of a labor organization engaged in an industry affecting commerce with intent to influence him in respect to any of his actions, decisions, or duties as a representative of employees or as such officer or employee of such labor organization.

(d) Any person who willfully violates any of the provisions of this section shall, upon conviction thereof, be guilty of a misdemeanor and be subject to a fine of not more than $10,000 or to imprisonment for not more than one year, or both.

FEDERAL RULES OF EVIDENCE
RULE 410

INADMISSIBILITY OF PLEAS, OFFERS OF PLEAS, AND RELATED STATEMENTS

Except as otherwise provided in this rule, evidence of a plea of guilty, later withdrawn, or a plea of nolo contendere, or of an offer to plead guilty or nolo contendere to the crime charged or any other crime, or of statements made in connection with, and relevant to, any of the foregoing pleas or offers, is not admissible in any civil or criminal proceeding against the person who made the plea or offer. However, evidence of a statement made in connection with, and relevant to, a plea of guilty, later withdrawn, a plea of nolo contendere, or an offer to plead guilty or nolo contendere to the crime charged or any other crime, is admissible in a criminal proceeding for perjury or false statement if the statement was made by the defendant under oath, on the record, and in the presence of counsel.

FEDERAL RULES OF CRIMINAL PROCEDURE
RULE 11(e)(6)

Inadmissibility of Pleas, Offers of Pleas, and Related Statements. Except as otherwise provided in this paragraph, evidence of a plea of guilty, later withdrawn, or a plea of nolo contendere, or of an offer to plead guilty or nolo contendere to the crime charged or any other crime, or of statements made in connection with, and relevant to, any of the foregoing pleas or offers, is not admissible in any civil or criminal proceeding against the person who made the plea or offer. However, evidence of a statement made in connection with, and relevant to, a plea of guilty, later withdrawn, a plea of nolo contendere, or an offer to plead guilty or nolo contendere to the crime charged or any other crime, is admissible in a criminal proceeding for perjury or false statement if the statement was made by the defendant under oath, on the record, and in the presence of counsel.

Supreme Court, U. S.
FILED
JUL 5 1978
MICHAEL RODAK, JR., CLERK

Nos. 77-1612 and 77-1761

In the Supreme Court of the United States

OCTOBER TERM, 1977

DAVID STIRLING, JR., ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

RUBEL L. PHILLIPS, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.,
Solicitor General,

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. App. A)[1] is reported at 571 F.2d 708.

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[1] "Pet. App." refers to the appendix to the petition in No. 77-1612.

JURISDICTION

The judgment of the court of appeals was entered on February 2, 1978. A timely petition for rehearing and suggestion of rehearing *en banc* was denied on April 13, 1978. The petition for a writ of certiorari in No. 77-1612 was filed on May 11, 1978. On May 3, 1978, Mr. Justice Marshall extended the time for filing the petition in No. 77-1761 until June 12, 1978, and the petition was filed on that day. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether petitioners' convictions were obtained in violation of the privilege against compulsory self-incrimination or the Double Jeopardy Clause.

2. Whether the trial court's charge on the materiality of petitioners' misrepresentations was correct.

3. Whether the trial court's instructions on the credibility of witnesses and reliance on expert advice were proper.

4. Whether the trial court properly permitted the prosecutor to question petitioner David Stirling on cross-examination concerning his prior plea of guilty in a related federal prosecution.

5. Whether the denial of petitioner Phillips' motion for a severance constituted an abuse of discretion.

STATEMENT

Following a jury trial in the United States District Court for the Southern District of New York, petitioners were each convicted on nine counts of securities fraud, mail fraud, and conspiracy.[2] Each was fined and sentenced to concurrent prison terms on the eight substantive counts;[3] sentences on the conspiracy count were suspended. The court of appeals affirmed in a comprehensive opinion (Pet. App. A).

The facts are set forth in detail in the opinion of the court of appeals (Pet. App. 3a, 7a-28a). Petitioners were officers and directors of the Stirling Homex Corporation (Homex), which was engaged in the

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[2] Count One charged petitioners with having devised a multi-million dollar scheme to defraud investors in violation of 15 U.S.C. 77q(a) and 77x; Count Two charged petitioners with making false statements in a registration statement filed with the Securities and Exchange Commission, in violation of 15 U.S.C. 77x; Counts Three through Eight charged them with mail fraud, in violation of 18 U.S.C. 1341; and Count Nine charged a conspiracy to defraud the United States and to violate 18 U.S.C. 1001, 18 U.S.C. 1341 and 15 U.S.C. 77q(a), 77x and 78ff, in violation of 18 U.S.C. 371.

Petitioners' co-defendant Edwin J. Schulz was also convicted on each of the nine counts charged in the indictment. He received a suspended sentence and one year's probation. His conviction was affirmed by the court of appeals.

[3] Petitioner David Stirling, Jr., was sentenced to concurrent one-year prison terms, to be followed by a one-year term of probation, and he was fined a total of $10,000. Petitioner William G. Stirling was sentenced to concurrent terms of six months' imprisonment, to be followed by one year's probation, and he was fined a total of $5,000. Petitioner Harold Yanowitch received concurrent one-year terms of imprisonment, to be followed by one year's probation, and he was fined a total of $2,000. Petitioner Rubel L. Phillips was sentenced to concurrent terms of 10 months' imprisonment, to be followed by one year's probation, and a total of $5,000 in fines.

manufacture and assembly of prefabricated multi-family modular housing. Homex was formed in 1968 and went into bankruptcy in 1972. In two separate underwritings in 1970 and 1971 Homex stock was sold to the public for approximately $39,000,000.

The evidence at trial revealed that petitioners misled the public by misrepresenting that Homex was in a sound and steadily improving financial position. The evidence further showed that the corporation's bookkeeping practices were deceptive; that three real estate transactions, represented as major land sales and used to boost apparent corporate sales totals, were in fact merely options; and that improprieties in connection with certain module sales were not disclosed. Furthermore, the company's labor relations were characterized as good without disclosure that company stock was improperly sold to union representatives at below market prices and that payment for the stock was facilitated by loans arranged and guaranteed by petitioner David Stirling. For their dealings with union representatives, petitioners David Stirling and Yanowitch were indicted in the Western District of New York on charges of violating Section 302 of the Taft-Hartley Act, 61 Stat. 157, as amended, 73 Stat. 537, 29 U.S.C. 186(a)(1). Prior to trial in the instant case, Stirling pleaded guilty to the Taft-Hartley violation and Yanowitch pleaded *nolo contendere* to that charge.

ARGUMENT

1. Petitioners contend (Pet. No. 77-1612, pp. 17-24) that their convictions violated both the privilege against compulsory self-incrimination and the Double Jeopardy Clause. Neither claim withstands analysis.

a. The self-incrimination argument is based on the fact that petitioners' securities fraud convictions rested in part upon their failure to disclose certain improprieties in Homex's labor relations. Disclosure of those improprieties, they claim, would have subjected them to prosecution under federal labor laws. Therefore, they argue, their securities fraud convictions improperly trenched on their Fifth Amendment rights. The court of appeals properly rejected this contention on the ground that the securities laws are essentially regulatory, the activity regulated is generally lawful, and the required reporting is not directed at a relatively small group of people suspected of criminal activity (Pet. App. 34a-35a). See *California* v. *Byers*, 402 U.S. 424; *Marchetti* v. *United States*, 390 U.S. 39; *Grosso* v. *United States*, 390 U.S. 62; *Shapiro* v. *United States*, 335 U.S. 1.

Beyond this, petitioners were not convicted of simply failing to disclose improper dealings with union representatives, but rather of making affirmative misleading disclosures with respect to their labor relations. They were not required to make any representations concerning their labor relations. Once they chose to do so, however, they were required to make full and accurate representations. Having determined

to make misleading disclosures, they should not now be heard to complain of the consequences. See *United States* v. *Mandujano*, 425 U.S. 564; *Garner* v. *United States*, 424 U.S. 648; *Bryson* v. *United States*, 396 U.S. 64.

b. Petitioners' double jeopardy claim is similarly insubstantial. They contend that because their convictions for securities fraud were based in part upon their nondisclosure of the facts underlying the Taft-Hartley convictions of petitioners David Stirling and Yanowitch in another district, their trial on the securities offenses violated the Double Jeopardy Clause.

As the court of appeals correctly ruled (Pet. App. 36a-37a), the two prosecutions were based upon entirely different acts. In the Taft-Hartley case, the government was not required to show any improper misrepresentation or nondisclosure concerning their labor relations. Conversely, on the securities fraud charge, the government was required to show only that there was a misleading failure to disclose the dealings with union representatives and not that the dealings constituted a Taft-Hartley offense or that petitioners themselves were the guilty parties. Since each offense required proof of facts that the other did not, the Double Jeopardy Clause does not bar prosecution for both. *Brown* v. *Ohio*, 432 U.S. 161, 166; *Blockburger* v. *United States*, 284 U.S. 299, 304.

2. Petitioners' objection to the court's charge with respect to the materiality of their misrepresentations (Pet. No. 77-1612, pp. 24-30) was not raised either

at trial or on appeal and there is no compelling reason for this Court now to consider the issue. *United States* v. *Lovasco*, 431 U.S. 783, 788 n.7; *United States* v. *Ortiz*, 422 U.S. 891, 898; Fed. R. Crim. P. 30.

In any event, the challenged instruction was not erroneous. Petitioners contend that the court improperly instructed the jury that it could find a statement or omission material if it "might" have induced an investor to act or not to act (Pet. No. 77-1612, p. 24). But in the portion of the charge quoted by petitioners (Pet. No. 77-1612, pp. 24-25 n.30), the court instructed the jury that the statement or omission had to be of such a nature that it "would or might reasonably have induced the person to act or not to act," and added that the jury would have to find that the information that was omitted or withheld "would, if disclosed, have significantly changed the nature of the information that was given" before it could find petitioners' actions material. Moreover, immediately before the challenged language the court instructed (Tr. 6009) that "[a]ll statements and omissions, though they might be of interest to somebody, are not necessarily material" and that "material fact in this setting is one which could reasonably be expected to induce a person relying on the statement to decide to act or not to act." This case is therefore unlike *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, upon which petitioners rely, for in context the use of the word "might" did not suggest that conviction

could be based on a " 'mere possibility, however unlikely,' " *Id.* at 449.[4]

3. Petitioners further contend (Pet. No. 77-1612, pp. 30-36) that the trial court's instructions on the credibility of witnesses and reliance on expert advice were erroneous. The court of appeals properly rejected these claims (Pet. App. 48a-50a).

a. Petitioners did not object at trial to the court's credibility instructions. Nor would any objection have been called for, as those instructions were wholly unobjectionable. Petitioners' claim to the contrary is based upon their juxtaposition of two separate portions of the charge (Pet. No. 77-1612, pp. 30-31; Tr. 6068, 6070-6071), each of which was entirely proper. A general instruction on credibility, such as the first passage of which petitioners complain, is almost mandatory when there is conflicting testimony in the case. *United States* v. *Partin*, 493 F.2d 750 (C.A. 5). The second passage, relating to the special interest that a defendant has in the outcome of a criminal case, is also a standard and unobjectionable charge. *Reagan* v. *United States*, 157 U.S. 301, 304-311; *United States* v. *Figurski*, 545 F.2d 389, 392 (C.A. 4); *United States* v. *Preciado-Gomez*, 529 F.2d 935, 942

[4] Petitioners appear to contend further (Pet. No. 77-1612, pp. 26-29) that the court of appeals held as a matter of law that their failure to disclose their illegal conduct was material in their securities fraud trial. The court did not so hold. The jury was instructed on the issue of materiality and resolved that issue against petitioners. The court of appeals merely held the evidence sufficient to sustain the jury's verdict (Pet. App. 31a).

(C.A. 9), certiorari denied, 425 U.S. 953; *United States* v. *Martin*, 525 F.2d 703, 706 (C.A. 2), certiorari denied, 423 U.S. 1035.[5]

b. The court's instruction concerning reliance on expert advice was also correct. The court properly instructed the jury that reliance on expert advice could serve as the basis for a conclusion that petitioners acted in good faith, but that reliance on expert advice after failing to give the expert complete information did not constitute acting in good faith (Pet. App. 50a). See *United States* v. *Tolkow*, 532 F.2d 853 (C.A. 2); *United States* v. *Smith*, 523 F.2d 771 (C.A. 5), certiorari denied, 429 U.S. 817; *United States* v. *Barbato*, 471 F.2d 918 (C.A. 1).

4. Petitioners next challenge the trial court's ruling that David Stirling's guilty plea and Yanowitch's plea of *nolo contendere* in the Taft-Hartley prosecution could be used against them at trial (Pet. No. 77-

[5] Read as a whole, the charge made clear that the credibility of witnesses was a matter for the jury alone to determine (Tr. 6068-6069). The trial judge also instructed the jury that "the fact that somebody is interested doesn't mean he is lying" (Tr. 6072).

This case is therefore unlike *Quercia* v. *United States*, 289 U.S. 466, upon which petitioners rely. There the trial judge had said in the charge, "I think that every single word that man said, except when he agreed with the Government's testimony, was a lie" (*id.* at 468).

Petitioners' reliance on *United States* v. *Cisneros*, 491 F.2d 1068 (C.A. 5), and *United States* v. *Fischer*, 531 F.2d 783 (C.A. 5), is also misplaced. Both involve extreme situations where the trial judge's comments served as a direction to the jury to ignore the testimony of the witnesses for the defense.

1612, pp. 36-42). Petitioner Stirling testified at trial, and he was asked on cross-examination whether, on January 21, 1976 (the day he had pleaded guilty), he had admitted causing things of value to be delivered to union representatives. Yanowitch did not testify at trial, and his *nolo contendere* plea was not introduced.

Petitioners did not raise this point in the court of appeals, and it is therefore not properly presented here.[6] In any event, the cross-examination with respect to Stirling's guilty plea and his statements made at the time of the plea was proper. At the time of trial the plea had not been withdrawn.[7] Although it was withdrawn while the appeal was pending in the Second Circuit, it has subsequently been reinstated.[8] Petitioners' contentions with respect to a subsequently withdrawn guilty plea are therefore no longer ap-

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[6] Petitioners David Stirling and Harold Yanowitch moved in the court of appeals to dismiss the appeal and remand it to the district court when their pleas were withdrawn, so that they could move in the district court for a new trial (Pet. App. 36a n.15). Neither in that motion nor in their brief, however, did petitioners make the evidentiary arguments they now seek to raise.

[7] Introduction of evidence of a guilty plea as to which a petition to withdraw is pending is analogous to the use for impeachment purposes, under Rule 609(e), Fed. R. Evid., of a conviction as to which an appeal is pending.

[8] Reinstatement of the plea was ordered on May 24, 1978, by Judge Harold P. Burke of the United States District Court for the Northern District of New York. *United States* v. *Stirling*, N.D.N.Y., CR 74-318 (May 24, 1978).

plicable. A guilty plea is, of course, admissible as a judicial admission. See *United States* v. *Andreadis*, 366 F.2d 423, 433 (C.A. 2), certiorari denied, 385 U.S. 1001; McCormick, *Evidence* 635 (2d ed. 1972).

5. Petitioner Phillips argues (Pet. No. 77-1761, pp. 7-13) that the district court erred in not granting his mid-trial motion for a severance.

Although petitioner Phillips suggests that his role in the conspiracy was extremely limited and that he was, at most, a "peripheral" defendant (Pet. No. 77-1761, p. 9), the facts show otherwise. As the court of appeals noted, petitioner played the key role in orchestrating the most blatant misrepresentation in the entire Homex scheme (Pet. App. 46a). He established a corporation to contract with Homex for the purchase of several thousand apartments in Mississippi. He subsequently forged a letter from the Farmers Home Administration committing the FmHA to make a $15,000,000 loan to the corporation to purchase the apartments. He also drafted further documentation purporting to show sales to the Mississippi corporation, which Homex was able to enter on its books to satisfy its auditors and commercial bankers. These false documents were repeatedly used by the other defendants to write millions of dollars of phony earnings into Homex's books. Finally, petitioner provided repeated confirmations of these phony transactions, which were used to deceive Homex's auditors (Pet. App. 18a-20a). Plainly, in light of both his

substantial interest in Homex [9] and his important role in the fraud, petitioner was not the "peripheral" defendant that he pretends to be.

In pressing his severance argument, petitioner Phillips argues that his motion for a severance, if granted, would have resulted in his being tried for his offenses in Mississippi (Pet. 7, 11-12). He also contends that he was denied a severance on the basis of misrepresentations of the prosecutor (Pet. 4, 13). Neither contention is correct.

Even if petitioner's case had been severed from that of his co-defendants, venue would still have been proper in the Southern District of New York. A severance would not have altered the charges against petitioner, and venue for each of those charges was properly set in the Southern District of New York. Although petitioner lived in Mississippi and committed many of his unlawful acts in Mississippi, each of the offenses charged was carried out, in part at least, in the Southern District of New York. Petitioner's assumption that a severance would have resulted in a change of venue is therefore erroneous.

Similarly misleading is petitioner's claim that he failed to move for a severance at the beginning of trial because of a misrepresentation by the prosecutor that the proof against him would be more extensive than it was (Pet. 4, 13). In fact, the government offered evidence at trial that petitioner had made pay-

[9] Petitioner Phillips was Southern Region Vice-President of Homex and owned an option to purchase 40,000 shares in the corporation (Pet. App. 3a).

ments to public officials to influence their official actions in connection with certain Homex affairs. On petitioner's motion, two weeks into the trial, the district court excluded this evidence (Tr. 770-786). Having kept from the jury this proof, which would have helped demonstrate his more extensive involvement in the fraudulent scheme, petitioner cannot now claim that the district court was misled or that the government misrepresented the scope of its proof against him at the beginning of trial.

In sum, rather than calling for reassessment of the settled principle that motions for severance under Rule 14 are committed to the discretion of the district courts, this case helps demonstrate why that principle is a sound one. The district court was best able to determine whether petitioner was subject to undue prejudice because of the joinder, and the court properly ruled that the benefits of the joint trial far outweighed any prejudice to petitioner from proceeding together with his co-defendants. *Schaffer* v. *United States*, 362 U.S. 511; *Opper* v. *United States*, 348 U.S. 84.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

DAVID STIRLING, JR., ET AL., *Petitioners*

v.

UNITED STATES OF AMERICA, *Respondent*

REPLY BRIEF FOR THE PETITIONERS

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REPLY BRIEF FOR THE PETITIONERS

The government's brief in opposition gives only routine treatment to the questions carefully and fully raised in the petition. This reply is offered to clarify the central points at issue in five areas covered by the petition.

I. SELF INCRIMINATION

Protection against inquisitorial use of the powers of government is the central guarantee of the self-incrimination clause of the Fifth Amendment. Subversion of that guarantee is precisely the issue raised by the petitioners here.

The off-hand response to the petitioners' constitutional claim by the government and the court of appeals below raises the threat of inquisitorial use of governmental power in three ways: (a) denial of any

relevance to the Fifth Amendment in the context of broadly directed regulatory information gathering schemes; (b) unrealistic appraisal of the "compulsion" necessary to implicate the Fifth Amendment; and (c) bypassing any serious attempt to assess or balance the personal and regulatory interests involved.

A. The government and the court of appeals below maintain that the Fifth Amendment only has relevance to regulatory reporting schemes if they are narrowly directed at an "inherently suspect" group in a field "permeated with criminal statutes." These were of course the circumstances in *Marchetti* v. *United States*, 390 U.S. 39 (1968), in which this Court held that the circumstances justified total refusal to comply with the regulatory reporting requirement.

But these circumstances cannot be the only ones in which a valid Fifth Amendment claim can be raised in the regulatory context, despite the holding of the court of appeals, and the position of the government. Pet. p. 20, n. 26. The Fifth Amendment would thereby be limited to protecting citizens from only the most transparent attempts to use regulatory statutes for prosecutorial, inquisitorial purposes. The greater danger is the situation presented here, where an otherwise valid regulatory reporting scheme is expanded to include requirements whose purpose is purely or predominantly inquisitorial. The issue is important because of the tendency reflected below to interpret the *Marchetti-Grosso*[1]*-Byers*[2] line of cases

[1] *Grosso* v. *United States*, 390 U.S. 62 (1968).

[2] *California* v. *Byers*, 402 U.S. 424 (1971).

mechanically and restrictively to the detriment of Fifth Amendment values.

B. Compulsion, in the simplest terms, is being required to do something on pain of penalty. This prosecution in itself would seem to refute any contention that petitioners were not under compulsion to reveal past crimes. Nonetheless, in support of its view that there was no compulsion here, the government cites a pair of cases holding only that a privilege to remain silent is not a privilege to lie (*see Bryson* v. *United States*, 396 U.S. 64 (1969); *United States* v. *Mandujano*, 425 U.S. 564 (1976)), and another case which stands for the proposition that the proper time to assert the Fifth Amendment privilege is at the time the incriminatory information is sought, *Garner* v. *United States*, 424 U.S. 648 (1976). The government asserts that petitioners could somehow have made satsifactory disclosures without self-incrimination or that, among several alternatives open to them, they chose misleading disclosure.

These arguments stray far from the facts. Petitioners' public representations concerning their labor relations were wholly accurate, not lies like the testimony involved in *Bryson* and *Mandujano*. Petitioners stated that current labor relations were stable but that no assurances could be given about the future. See Pet. pp. 7-8. The stock transactions with union officials which formed the basis for petitioners' indictments under the Taft-Hartley Act are perfectly consistent with this general statement, no matter how black the government paints those transactions. There is simply no basis for maintaining that the details

omitted are material unless they are material precisely because they reflect illegality.[a]

The government and the court of appeals maintain that petitioners "chose" to mislead the public. The reasoning is that petitioners were not compelled to discuss labor relations, but once they did so, they were obligated to do so truthfully. This argument is a pyramid of errors:

First, petitioners' representations were truthful.

Second, from the viewpoint of materiality and the interests of the investing public, it cannot fairly be maintained that the public would have been better informed with no labor information rather than the fair current assessment and future caution which the petitioners provided.

Third, petitioners did not "choose to lie." They thought they were telling the truth; and they did not and could not know of the expansion of the concept of materiality which would make bland statements of fact tantamount to criminal fraud. Pet. pp. 28-29. Petitioners did not have the knowledge or the choice available in *Garner* v. *United States, supra,* where the taxpayer/gambler presumably knew the impact of his admission on his tax return that he was a gam-

[a] The government cites the discussion of the court of appeals on the evidence as a whole, and on the evidence relating to proof of conspiracy, as proof that the court of appeals did not construe the illegality of petitioners' actions as the reason those actions were material. Brief in Opposition, p. 8. The discussion makes no mention of materiality. Where materiality is discussed by the court of appeals, the illegality of petitioners' conduct is clearly adduced as the support for the contention that the petitioners' omission to discuss that conduct was material. Pet. App. 38a; Pet. pp. 18, n.23; 26-30.

bler, and chose to make the admission rather than assert a claim of privilege or remain silent. The petitioners here had no comparable choice, and there is no basis for a claim that petitioners made a "knowing and intelligent" waiver of their rights in these circumstances. *See Mandujano, supra,* 425 U.S. at 584-609. (Brennan, J., concurring).

Prosecution of the petitioners in these circumstances denies them any way to comply with the government's reporting scheme without direct self-incrimination, an alternative which this Court found to be available to the gambler in *Garner,* 424 U.S. at 661, n.15, and the motorist in *Byers,* 402 U.S. at 431 (Burger, J., for the plurality); 402 U.S. at 436 (Harlan, J., concurring in the judgment).

Before this Court faced the matter of confessions obtained through custodial interrogation in *Miranda* v. *Arizona,* 384 U.S. 436 (1966), the coercive reality of normal police practices had been ignored, and as a result those practices mocked the requirements of "voluntary" confession uniformly announced in judicial opinions. *See Miranda,* 384 U.S. at 445-456. Unless the issue of regulatory compulsion is faced here, there is the same danger of government practices steadily increasing their distance from constitutional principles, until the Fifth Amendment protection against the inquisitorial use of government power is worthless in the regulatory context.

C. The government never faces the issue identified as crucial in *California* v. *Byers,* 402 U.S. 424 (1971): the balance between the regulatory need for information and the individual interest in avoiding self-incrimination. The highly questionable concept of materiality on which the Government's case on the

labor issue rests, and the directly incriminating nature of the required admissions, should make this balance clear. Pet. pp. 18-24. It is important for this Court to deal with the issue in part because the government and the court of appeals have, contrary to *Byers,* ignored it completely.

II. DEFINITION OF MATERIALITY

As should be clear from the discussion above, the definition of materiality under the securities laws—particularly as applied to an omission—has been a central issue in this case from the beginning. The petitioners' claims relating to self-incrimination can neither be resolved nor avoided unless the issue of proper construction of "materiality" under the federal securities acts is faced. As such, the materiality issue, including the erroneous charge of the trial court and erroneous construction by the court of appeals, should be regarded as properly before this court on several grounds.

A. It is proper to face the materiality issue fully in order to construe both the statute at issue, 15 U.S.C. § 77q, and the prior opinion of this Court in *TSC Industries, Inc.* v. *Northway,* 426 U.S. 438 (1977), so that the Court may avoid decision of the constitutional issues by a limiting interpretation of the statutory duty imposed on the petitioners. *See, e.g., Boynton* v. *Virginia,* 364 U.S. 454, 457 (1960) (case decided on previously unraised statutory grounds in order to avoid necessity for decision on constitutional issues).

B. Like the indictment in *Silber* v. *United States,* 370 U.S. 717 (1962), the instruction by the trial court below was in direct conflict with a recent holding of

this Court. As this Court found in *Silber,* the failure to raise the issue below should not preclude reversal of "plain error" such as this. Rule 40(1)(d)(2) of the Rules of this Court. The government's labored explanation of how the phrase "would or might" in the instruction below really means "would" cannot erase the flat conflict between the instruction below and this Court's holding in *TSC Industries, Inc.* v. *Northway,* 426 U.S. 438 (1977). If the *TSC* ruling is to be at all enforceable, its application cannot depend on strained attempts to extract, from lengthy instructions, intimations which might conceivably counteract the disapproved effect of the "might" language actually used by the trial court.

The crucial importance of jury instructions in criminal matters has often led this Court to invoke the "plain error" rule to review erroneous trial instructions not complained of below. *See, e.g., Pipefitters Local Union No. 562* v. *United States,* 407 U.S. 385, 440-442 (1972); *Terminiello* v. *Chicago,* 337 U.S. 1, 5, 6 (1949); *United Brotherhood of Carpenters & Joiners of America* v. *United States,* 330 U.S. 395, 411, 412 (1947).

C. The "would or might" instruction of the trial court clearly expands the duty to report beyond the limits set in the *TSC* case and, in the circumstances here, this instruction contributed to a finding of materiality which makes the reach of the petitioners' statutory duty to report unconstitutional. In these circumstances, review of the charge, as well as review of the construction by the court of appeals of the materiality requirement, should be proper because of the relevance to the properly raised constitutional claim. *See United States* v. *Speers,* 382 U.S. 266 (1965).

In *Speers* this Court dealt with a complex issue regarding interpretation of section 70(c) of the Bankruptcy Act, and section 6323 of the Internal Revenue Code. The government raised in this Court an argument based on section 67(b) of the Bankruptcy Act which was not raised in the court of appeals, or before the district court or referee. This Court nonetheless held that this contention was properly before it (382 U.S. at 277, n.22):

> "The 67b argument raised in this Court differs from that rejected below, for that subsection is now cited to us as an aid in construing the relationship between 70c and 6323. Insofar as it is relevant to the particular problem of statutory construction presented by this case, we regard the 67b argument as properly before us, for 'Where the mind labours to discover the design of the legislature, it seizes everything from which aid can be derived.'" (Citations omitted.)

D. Finally, because of its relationship to the constitutional issues and its importance to the proper scope of the securities acts and the power of the Securities and Exchange Commission to enforce those acts, the materiality issue is a fundamentally important question both in the context of this case and beyond. As such it warrants review by this Court under Rule 23(1)(c) of this Court's Rules.

Though the circumstances are very different, the considerations favoring review of the materiality issues here are very similar to those enunciated by this Court in *Connor* v. *Finch*, 431 U.S. 407 (1977). *Connor* involved a challenge to reapportionment plans promulgated by a district court for the Mississippi legislature. The petitioners challenged the Senate plan as a whole, but only challenged some of the districts in the House plan. Nonetheless this Court decided to consider and overturn the House plan as a whole, noting that the validity of the plan could be viewed as raised by implication and emphasizing, moreover, the general "duty in exceptional circumstances" to review federal court errors not raised below when those errors "seriously affect the fairness, integrity or public reputation of public proceedings." 431 U.S. at 421, n.19. Both factors are present here, where determination of the materiality issues is central to a determination of the constitutional ones, and where the instruction below, in direct conflict with a recent holding of this Court, allowed materiality and guilt to be determined on the basis of a "mere possibility" (*TSC, supra*, 426 U.S. at 448-449) that the information in question would affect investment decisions. The fundamental integrity of both judicial and administrative processes are affected, to the detriment not only of these petitioners, but of other individuals who seek to comply with, or are prosecuted under, the securities laws.[4]

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[4] It has been clear from the outset of this case that the gist of the petitioners' constitutional defense on the labor relations issue is that the concept of materiality cannot be stretched to require that they explicitly incriminate themselves in filings under the securities acts. This issue has been pressed and contested in various formulations at every level of this proceeding, from the pretrial motion to strike paragraph sixteen of the indictment through the court of appeals to the petition for a writ of certiorari. There is certainly no undue prejudice to the Government in consideration of the issue. As this Court stated in *Perma Life Mufflers, Inc.* v. *International Parts Corporation*, 392 U.S. 134, 142 (1968), in upholding the right of the petitioner there to urge alternative theories of antitrust conspiracy liability:

> The gist of petitioners' cause of action has been clear from the outset, and respondents will in no way be prejudiced if petitioners are permitted to rely on these alternative theories of conspiracy.

III. THE PREJUDICIAL CREDIBILITY CHARGE

The government contends that the instruction given by the trial court on the credibility of witnesses was "entirely proper." (Brief in Opp. p. 8.)[5] This conclusion rests on the assumption that the first section of the contested charge was no more than "a general instruction on credibility" and that the second section of the charge was "standard and unobjectionable." (*Id.*) This assumption is belied by the facts. The trial court's charge included the prejudicial statement that "I think it is reasonably safe to suggest that you heard more than once perjury from the witness stand in this case." (A. 657.) This statement goes far beyond a "general instruction on credibility." The second part of the charge indicated to the jury that defendants had "deep and profound and abiding interest in the outcome of the case." (A. 659-60.) Taken together, these two sections of the charge are not "entirely proper" because a trial court's "lightest word or intimation is received with deference, and may prove controlling," *Starr* v. *United States,* 153 U.S. 614, 626 (1894), and the impact of the trial judge on the jury is great. *Quercia* v. *United States,* 289 U.S. 466, 470 (1933). The Government has not properly faced the rule of *Quercia* or the conflict between the court below and the Fifth

[5] The government does not contend that this question is not properly before this Court, but only that petitioners did not object to the instruction in the trial court, and could not have, because it was "wholly unobjectionable." (Brief in Opp., p. 8.)

Circuit.[6] Reversal is required because as this Court stated in *Quercia,* "hostile comment of the judge should not render vain the privilege of the accused to testify in his own behalf." *Id.*

IV. THE USE OF YANOWITCH'S NOLO CONTENDERE PLEA

The government does not respond at all to petitioners' contention that use of petitioner Yanowitch's plea of nolo contendere (the conviction was later withdrawn although recently reinstated) for purposes of impeachment was incorrect, nor could it.[7] *Cf. Mickler* v. *Fahs,* 243 F.2d 515, 517 (5th Cir. 1957). The very name of the plea "nolo contendere" means only "I do not contest." *Piassick* v. *United States,* 253 F.2d 658 (5th Cir. 1958). The plea is not a judicial admission, nor even a prior inconsistent statement of culpability, and it cannot be used as such. (See Pet. p. 40, n.50.)

[6] The Government contends that petitioners' reliance on *United States* v. *Cisneros,* 491 F.2d 1068 (5th Cir. 1974), and *United States* v. *Fischer,* 531 F.2d 783 (5th Cir 1976), is misplaced because each involved "extreme situations where the trial judge's comments served as a direction to the jury to ignore the testimony of the witnesses for the defense." (Brief in Opp. p. 6, n.5.) Yet this is exactly what the charge in this case directed the jury to do, particularly when combined with an instruction stressing the likelihood that the government's immunized witnesses were testifying truthfully.

[7] Petitioners raised the issue of the admissibility of David Stirling's plea of guilty and Harold Yanowitch's plea of nolo contendere in the court of appeals when they moved for dismissal of the appeal without prejudice and for remand of the case. (Pet. App. A, p. 36a, n. 15.) Petitioners raised the issue with the trial court before, at and during trial. (Tr. 20-21, 2884-2888, 3348-3354, 4107-4111, 4185.)

A. The ruling of the court below that the plea of nolo contendere was admissible for impeachment conflicts with the view of the Fifth Circuit. *United States* v. *Morrow,* 537 F.2d 120, 141-145 (5th Cir.), *rehearing denied,* 541 F.2d 282 (5th Cir. 1976).

B. Most importantly, the ruling of the court below vitiates the ability of a defendant to choose a nolo contendere plea, a plea expressly permitted by the federal rules. The ruling permitted the government by indirection to use a plea for impeachment as an admission when it could not be used as an admission directly,[8] and allowed petitioner Yanowitch to be intimidated from exercising the right to testify on his own behalf.

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[8] *See also Kilgore* v. *United States,* 467 F.2d 22, 27-29 (5th Cir. 1972) (in a tax refund suit, plaintiff's reputation witness could be asked on cross examination if he had heard that plaintiff had pleaded nolo contendere in the prior criminal tax fraud case, but the court noted that the result would be different if the question was put to the criminal defendant himself); *Mickler* v. *Fahs,* 243 F.2d 515 (5th Cir. 1957) (questioning of defendant about prior plea of nolo contendere, after objection, and despite instruction that question should be ignored for all purposes, held reversible error); and *Piassick* v. *United States,* 253 F.2d 658 (5th Cir. 1958) (admission of question about conviction based on a plea of nolo contendere, over objection, and despite limiting instruction, held reversible error.) *See also United States* v. *Ward,* 481 F.2d 185, 186 (5th Cir. 1973); *cf. Commissioner* v. *Estate of Leyman,* 344 F.2d 763 (6th Cir. 1965), *vacated on other grounds,* 383 U.S. 832 ((1966) (copy of conviction based on plea of nolo contendere in criminal tax case admissible for impeachment of credibility in the Tax Court non-jury trial for penalties and additional taxes.)

V. THE USE OF DAVID STIRLING'S GUILTY PLEA

The guilty plea withdrawn by David Stirling has been reinstated. Whether a plea is subsequently reinstated or not, there is another issue with which the government does not deal at all. It is highly prejudicial to use for impeachment a conviction arising from the same transaction for which a defendant is later tried. *United States* v. *Martinez,* 555 F.2d 1273 (5th Cir. 1977). In *Martinez,* the defendant was on trial for conspiracy to distribute cocaine. The court held that it was an abuse of discretion to permit impeachment by a prior conviction for aiding and abetting "arising out of the identical factual circumstances and involving many of the identical elements as the offense on trial." 555 F.2d at 1277. The conviction of petition Stirling here derived from the same factual circumstances and involved the same elements (giving a thing of value to union officials) as the earlier trial. Thus, even if the plea of guilty made by petitioner Stirling and the corresponding conviction have been reinstated, the decision of the Second Circuit conflicts with the decision of the Fifth Circuit in *Martinez.*[9] It thus requires review by this Court.

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[9] In *Martinez* as here, the "defendant's right to have the jury determine that the government has properly proven every essential element beyond a reasonable doubt was improperly prejudiced by the introduction of the former conviction." *United States* v. *Martinez,* 555 F.2d at 1276-1277. These considerations are particularly cogent here where the "separate" crimes are the same in terms of the double jeopardy analysis established in *Blockburger* v. *U.S.,* 284 U.S. 299 (1932), and *Brown* v. *Ohio,* 432 U.S. 161 (1977), See Pet. pp. 22-24.

CONCLUSION

The errors summarized above were cumulative, and in the aggregate they materially affected the fairness of petitioners' trial. Review of the decision below by this Court is appropriate, and the petition should be granted.

Respectfully submitted,

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